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FEDERAL DEPARTMENTS' AND AGENCIES' FAILURE TO COLLECT AUDIT-RELATED DEBTS

ORIGINAL

HEARING

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

COMPLETED

NINETY-SEVENTH CONGRESS

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FEDERAL DEPARTMENTS' AND AGENCIES' FAILURE TO COLLECT AUDIT-RELATED DEBTS

WEDNESDAY, FEBRUARY 24, 1982

House of Representatives,
Legislation and National Security Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2203, Rayburn House Office Building, Hon. Jack Brooks (chairman of the subcommittee) presiding.

Present: Representatives Jack Brooks, Dante B. Fascell, Don Fuqua, Elliott H. Levitas, Henry A. Waxman, Frank Horton, and William F. Clinger, Jr.

Also present: Subcommittee staff: Richard C. Barnes, staff director; Robert Moreno and Mary V. Heuer, professional staff members; and Linda Shelton, office manager; full committee: William M. Jones, general counsel; John M. Duncan, minority staff director; Thomas F. Houston, minority professional staff, Committee on Government Operations; and Greg Ulans, GAO detailee assigned to committee.

OPENING STATEMENT OF CHAIRMAN BROOKS

Mr. Brooks. The subcommittee will come to order.

Today the subcommittee continues its efforts to improve management, efficiency, and accountability in our Federal Government.

The purpose of today's hearing is to review what actions Government agencies are taking to collect funds which their auditors have found were used improperly.

Three years ago, GAO first reported that Government departments and agencies were losing billions of dollars by failing to follow up and resolve audit findings. The subcommittee held hearings at that time, and the then OMB Director, Jim McIntyre, responded quickly with changes to the OMB circular on audit resolution. Those changes were constructive. Some improvements were made.

Last year, however, we followed up to determine what the agencies had accomplished in this area. We found that many agencies had not implemented the new OMB guidelines. The subcommittee again held hearings, and we were pleased to hear Deputy Director of OMB Ed Harper tell us that President Reagan is strongly committed to the audit process and that this administration has made audit resolution a high priority. We also have been pleased to hear reports of the progress they say they are making in resolving audits and recovering misspent funds.

The Government Operations Committee has worked hard to reduce waste and to improve the efficiency of the Federal Government under many administrations. It played a leading role in creating Offices of Inspectors General in 15 agencies. The offices have more than paid for themselves through their work in eliminating wasteful and fraudulent practices in the use of Government funds. I am hopeful that the Senate will eventually approve legislation which the House has already passed creating Inspector General offices in other major agencies of the Government—the Departments of Defense, Treasury, and Justice.

This will help, but alone it is not enough to make Government more accountable. The managers of the departments and agencies must take action on the findings of the Inspectors General and other internal auditors in Government if we are going to be really successful in reducing waste, fraud, and abuse—or even mismanagement.

Today we are going to examine the final and most important step of the audit resolution process—collecting the money which was misspent. We will first hear from the Comptroller General on the results of the General Accounting Office's most recent review. What we are going to hear is not going to be very encouraging. Unfortunately, GAO is going to tell us that many agencies do not even know the total amount owed to them as a result of their audits.

Following GAO, we will hear from representatives of the Office of Management and Budget on the status of its efforts to improve audit resolution, what steps the OMB is taking to improve the collection of audit-related debts, and whether or not they believe the collection of these debts is a serious problem.

Mr. Horton?

Mr. HORTON. Thank you, Mr. Chairman.

This subcommittee has, for the last 3 years, documented a disturbing pattern of unresolved audit findings in many Federal agencies and departments. The bottom line of that pattern, of course, is that far too many unresolved audit findings are resulting in uncollected debts and in unnecessary losses of Federal tax dollars.

In view of our established interest in audit resolution and in improving efficiency throughout the Federal Government, it is appropriate that the subcommittee take our review one step further. How effectively, for example, do agencies and departments collect the millions of tax dollars which are owed to the Government once audit findings are finally resolved? How much is written off as unrecoverable? If GAO has identified $374 million in uncollected audit-related debts at just seven agencies, how much is not collected at other agencies?

It should be pointed out, of course, that poor debt collection did not begin with the current administration or even with the last administration. It is a persistent and costly failure which needs to be addressed and needs to be corrected.

I realize that there are differences of opinion on the very definition of audit resolution. Still, once an audit finding is resolved, there should be no difference of opinion on the obligation to collect any money owed to the Government.

I am anxious, Mr. Chairman, to hear about GAO's findings and learn more about their recommendations for improving the situation. I also look forward to hearing from the Office of Management and Budget.

I join you in welcoming our distinguished witnesses, Comptroller General Bowsher and OMB Associate Director Steinberg.

I might say, parenthetically, that at about 8:15 this morning, I received a telephone call from the OMB Deputy Director, Ed Harper, who is in San Francisco at the present time. That meant that he was calling me at about 5:15 this morning, his time.

He wanted me to express to you, Mr. Chairman, his regrets that he could not be here to testify himself. He also, in response to my congratulations to him over taking on a new responsibility in the administration—which will have him working very closely with Mr. Meese—I suggested to him that the chairman and I were still very much interested in getting the IG—Inspector General—bill through and getting it signed by the President. He told me that he was working on that and that they thought that they had something worked out in the Senate. At the right time, he said, they will be moving on it.

I hope we can get that done, as you have already indicated. That is a very important step, I think, as far as the American people are concerned. I know that we are checking and that the Department of Defense is also checking on fraud, waste, and abuse.

I join with you in welcoming our witnesses.

Mr. BROOKS. Thank you, Mr. Horton. I understand that Mr. Harper will now turn in one of his two hats and and replace it with one big one. I think he probably has the brains to go with that. It is going to be rather difficult, so we will have to wait and see how he does over there.

Our first witness this morning is Charles A. Bowsher, Comptroller General of the United States.

Mr. Bowsher is a graduate of the University of Illinois and received an MBA degree from the University of Chicago in 1956. He was associated with Arthur Andersen and Co. in Chicago from 1956 to 1967.

In 1967, Mr. Bowsher was appointed Assistant Secretary of the Navy for Financial Management by President Johnson and continued to serve in that capacity until 1971. Mr. Bowsher returned to Arthur Andersen in June 1971 as a partner in the firm. He was appointed Comptroller General by President Reagan last year under the provisions of a bill passed by this committee. He was the first one appointed under that provision. I think it turned out rather well.

He is accompanied today by Mr. J. Steven Sadler, Deputy Associate Director of the Accounting and Financial Management Division, and Mr. Randolph Jones, Supervisory Evaluator from the San Francisco Regional Office of GAO.

Gentlemen, it is a pleasure to have you with us today.

General, you may proceed with your statement.

STATEMENT OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY J. STEVEN SADLER, DEPUTY ASSOCIATE DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, AND RANDOLPH JONES, SUPERVISORY EVALUATOR, SAN FRANCISCO REGIONAL OFFICE

Mr. **Bowsher.** Thank you very much, Mr. Chairman and members of the subcommittee.

We are pleased to be with you today to discuss the results of our governmentwide review of problems with Federal agencies' actions to collect debts arising from audits.

My testimony today will summarize the major issues addressed in our report, Federal Agencies Negligent in Collecting Debts Arising from Audits, issued to you, Mr. Chairman, on January 22, 1982.

The report is the third in a series of reports, all done upon your requests, on how Government agencies follow up on and resolve findings identified through the audit process. Our two earlier reports resulted in hearings before your subcommittee in 1979 and 1981. Your committee also issued two reports covering Government agencies' failure to take effective action on audit findings.

The collection of audit-related debt is a significant part of the entire Federal debt collection process. Both GAO and the Congress have been seeking improvements in the Government's ability to collect all debts.

Three bills, in fact, have been introduced in Congress to help correct debt collection problems: the Debt Collection Act of 1981, S. 1249; the Debt Collection Improvement Act of 1981, H.R. 2543; and the Debt Collection Act of 1981, H.R. 2811, the last of which you introduced.

In addition, the Office of Management and Budget, the President's Management Improvement Council, and the President's Council on Integrity and Efficiency have all recognized the importance of improving debt collection and have made it a priority issue. In fact, the President's budget for 1983 identifies debt collection as one of its management initiatives.

Our report shows that Federal agencies are doing a poor job of managing and collecting audit-related debts because of poor accounting and collection control systems and poor management practices. When I say "audit-related debts," I am speaking of those amounts which both auditors and Federal program managers have agreed were misspent and, therefore, owed to the Federal Government.

We also found that, when audit-related debts are paid or otherwise settled, Federal departments and agencies have no assurance that payments are made with non-Federal funds or that when these debts are settled, that Federal programs are maintained at the same level.

We found that Federal agencies' collection systems are often so inadequate that the total amount of audit-related debts due the Government cannot be determined. Despite statutory and administrative requirements to aggressively collect debts, we found that the $374 million of audit-related debts which were identified by relatively few agencies remain uncollected for years.

Based on a questionnaire which we sent to the 36 Federal agencies with the largest amounts of monetary audit findings and a detailed review at 7 of the agencies responding to the questionnaire, we conclude that agencies: One, are slow to determine the amount of audit debt subject to collection; two, do not promptly bring debts under accounting control; three, delay collections because of weak monitoring efforts; and, four, rarely pursue collections of subgrantee audit-related debts.

OMB requires that agencies make written determinations on all audit findings within 6 months after issuance of the audit reports and that agencies establish accounting and collection controls over amounts determined by the audits to be due the Government. We found that many agencies are not making these written determinations within the 6-month period, and once the amount of disallowed costs is determined, agencies are not establishing accounting and collection controls over the amounts.

Furthermore, the Federal claims collection standards require agency heads to take prompt, aggressive action with effective followup to collect debts due the United States. However, in this regard, we found agency collection efforts to be ineffective, irregular, and infrequent.

Under contractual law, grantees are responsible for Government funds spent by their subgrantees. Generally, when the funds are spent for unauthorized expenses, the grantee is responsible for the repayment of the funds.

Yet, we found that agencies either are not requiring grantees to repay subgrantee debts at all or that they are not requiring grantees to repay these debts promptly.

Furthermore, we found that, when Federal agencies attempt collection of subgrantee debts from grantees, some grantees have refused to pay, and no further action to resolve the claim is taken. For example, one grantee refused to repay $501,000 of subgrantee debts to the Federal agency until or unless the subgrantees repaid the funds. Yet, four of the five subgrantees involved had no resources to repay.

In addition to the poor accounting and control systems, we noted a number of poor management practices which we believe contribute to the agencies' inability to collect audit debts promptly and effectively.

Specifically, we noted that agencies are inappropriately forgiving debts without a reasonable collection effort. The claims collection standards supported by a 1978 Comptroller General decision require agencies to aggressively collect all claims of the United States and not waive recovery of grant funds. At one regional office of the Department of Agriculture, we found that $12 million in audit-related debts were waived without even attempting collection.

A second poor management practice we noted was that agencies have allowed legitimate appeal processes to be used by grantees to delay payment of their debts at a cost of millions of dollars to the Federal Government. We found that most disallowed costs are appealed. The appeals process is time consuming, and many of the appeals are often withdrawn prior to settlement.

While we are not questioning the right to appeal, we believe changes must be made to discourage groundless appeals and that Federal agencies must insure that legitimate appeals are processed without undue delay. One method to accomplish these objectives is to accrue interest while debts are under appeal.

A third poor management practice we noted was that agencies have not charged interest over the last 3 years on hundreds of millions of dollars in delinquent debt. Since April 1979, the claims collection standards have required that agencies charge interest on delinquent debts according to the Treasury Fiscal Requirements Manual. Yet, only one agency, of all those responding to our questionnaire, reported an amount of interest collected, and this amount was only $3,100.

Agencies reported $374 million of audit-related debt outstanding as of June 30, 1981. If it takes agencies 1 year, to process and collect this debt, which agencies reported to be the average length of time for debt recovery, we estimate that about $66 million in interest could be collected on this audit-related debt.

Let me point out though that we believe the potential interest income is even greater than this because all of the audit-related debt was not reported to us.

In addition to the lack of accounting and collection controls and poor management practices, we found that Federal agencies unknowingly accept funds provided under Federal grant programs, which obviously were provided for purposes other than repayment of debt.

Furthermore, Federal agencies have no assurance that Federal programs have been maintained at the intended level.

We also found that, when debts are repaid by the use of offset, agencies have no assurance that non-Federal funds equal to the amount of the offset were restored to the Federal program to keep it at the intended funding level. When repayments of audit-related debts are made in cash, most agencies do not know the source of the payments or whether the repayment reduces program benefits. We found several cases at HUD [Department of Housing and Urban Development] where program benefits may not have been maintained when audit debts were repaid.

Our report, Mr. Chairman, sets forth recommendations which we believe will correct the problems I have mentioned. We have recommended that the heads of Federal agencies implement policies and procedures which do the following:

They require a written determination of the allowability of all questioned costs within 6 months of audit report issuance.

They insure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

They insure aggressive collection action in accordance with the claims collection standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of funding.

They hold grantees fully responsible where they are liable for the debts of their subgrantees and apply the claims collection standards in collecting these amounts.

They insure compliance with the claims collection standards to preclude the termination of any debts over $20,000 and insure that all claims collection standards concerning compromise and termination are met before settling debts of $20,000 or less.

They streamline the audit disallowance appeal process to insure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

They require interest to be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition.

They require grantees to certify that their payment of audit-related debts does not reduce the level of benefits of any Federal program and institute program and audit followup.

Furthermore, Mr. Chairman, we have recommended that the Director of the Office of Management and Budget incorporate these recommendations in the management circular on audit resolution which is currently being revised and then follow up to insure that agencies are complying.

This concludes my prepared statement. My colleagues and I will be pleased to respond to any questions you or other members of the subcommittee may have.

Mr. BROOKS. General, we appreciate your coming down. I have a few questions I will ask you and a few which I will submit for the record.

First, how much money has the Government collected in audit disallowances over the past several years? Do you have a figure on that?

Mr. BOWSHER. Yes. In response to our questionnaire, 16 Federal departments and agencies stated that, as of June 30, 1981, they had recovered $278 million in audit-related debts. The recoveries covered costs disallowed in the fiscal years 1978 through 1980.

We do believe, however, that this amount is understated because 11 departments and agencies did not provide us any data on audit recoveries.

Mr. BROOKS. The amount of audit-related debt the GAO reported for the 3-year period is much less than what OMB reported recovered for a 6-month period. Can you explain the difference in the figures?

Mr. BOWSHER. There is a difference based on the department and agency responses to our questionnaire from what has been reported to the GAO. We have the OMB figures now, and we are in the process of looking at them.

Just as an illustration, the Department of Transportation reported $190 million in recoveries to OMB during the 6-month period, while only reporting $20 million for a 3-year period to us. We are looking at the differences. I do not have them reconciled at this time.

Mr. BROOKS. How inadequate are agency accounting systems for controlling audit-related debts? As a professional accountant who has worked both in and out of government, what is your opinion?

Mr. BOWSHER. They are inadequate, as a general statement. Let me point out what we found in this review. At four of the seven agencies where we did the review—USDA [Department of Agriculture], EPA [Environmental Protection Agency], HUD, and DOT [Department of Transportation]—accounts receivable were not even established for a lot of disallowances to bring them under accounting control.

In addition, in nine other agencies responding to our questionnaire, they did not establish accounts receivables for these debts.

Therefore, it is, I think, a real problem.

Mr. BROOKS. Under present law, can agencies charge interest on delinquent audit-related debt?

Mr. BOWSHER. Yes, they can, Mr. Chairman. What we found is that they are not doing so.

If the payment is overdue, a late charge will be applied at a percentage rate, based on the current value of funds to the Treasury. That is the way the Treasury Fiscal Requirements Manual reads right now.

When we were doing our review, only one agency, HHS [U.S. Department of Health and Human Services] reported a specific amount of interest collected. They originally reported to us $3.2 million. Later, after investigation, it was only $3,100. That is quite a discrepancy.

Thirteen agencies did report that they charge interest on audit-related debts, and three of the agencies reported collecting interest on more than 10 percent of the recovered disallowances, but no agency besides HHS was able to provide any data to us on interest collected.

Mr. BROOKS. Does an agency's collection of audit-related debt sometimes result in repayment by the grantee with other Federal funds or a reduction in the benefits of the Federal program involved?

Mr. BOWSHER. Yes. In fact, in one case, a subgrantee repaid disallowed costs to a HUD grantee by endorsing a check which it had received from CETA which is, of course, in the Department of Labor. No effort was made by either agency to verify that performance was maintained in the respective programs.

Officials at HUD, USDA, EPA, and DOT told us that, either they were not concerned about the source of funds to pay grantee debts or that they had no way of determining the sources.

Most Federal agencies do not instruct auditees in demand letters that the payment of audit-related debt must come from non-Federal funds, nor do they require auditees to certify that they repaid the funds from non-Federal sources.

Mr. BROOKS. Once you have them, they are fungible.

Mr. BOWSHER. That seems to be the case.

Mr. BROOKS. Is that not about right?

Mr. BOWSHER. That is right.

Mr. BROOKS. I have seven other questions, General, which would be very helpful to us if you would provide responses to for the record.

Mr. BOWSHER. We would be happy to do so.

Mr. BROOKS. Without objection, the questions and answers will be included as part of the record at this point.

[Submissions to additional questions by Chairman Brooks follow:]

ADDITIONAL QUESTIONS FOR THE GENERAL ACCOUNTING OFFICE FROM CHAIRMAN BROOKS

Question Number 1: How accurate is your figure of $374 million in outstanding audit-related debts?

Answer: Federal departments and agencies reported to us a total of $374 million in outstanding audit-related debts as of June 30, 1981. However, we believe this amount to be vastly understated because many Federal agencies did not provide us the amount of their audit-related debts and because of the widespread lack of adequate systems to control these debts. Four departments and agencies (USDA, Commerce, NASA, and VA) could not provide any data. However, in just one region of USDA we found $8.1 million in audit-related debt outstanding as of June 30, 1981. In addition, eight other Federal departments and agencies reported they had no outstanding audit-related debts.

Of those agencies that reported some outstanding audit-related debts, we question whether the reported amount is even the entire amount owed. The reason for our doubt is that EPA, for example, reported only $1.5 million outstanding as of June 30, 1981. However, an audit report issued by the Inspector General for EPA on September 30, 1981, showed $25.5 million in audit-related debts outstanding. Even this latter amount is probably understated since it only relates to those audit reports issued in FY 1979 and the first six months of FY 1980.

Question
Number 2: What was the most common deficiency found in your review?

Answer: At all seven agencies where we did our review, the lack of a management priority by agency officials both at top and middle-management to aggressively pursue debt collection is the most common problem we found. This is evidenced by agencies' poor accounting and collection control systems and poor management practices. When agency officials make debt collection a top priority, then they will implement the recommendations in our report. These recommendations will only result in faster and better debt collection if agency management vigorously support these concepts.

Question Number 3: Did you find any Government agency with adequate accounting and collection controls over audit disallowances?

Answer: At the seven agencies where we reviewed the handling of audit-related debts, no agency had adequate accounting and collection controls. Although some agencies (notably Education, HHS, and Labor) establish accounts receivable for audit-related debts, no agency has been doing this on a timely basis. None of the agencies have been promptly collecting outstanding audit-related debts and the monitoring of this debt has been ineffective. Follow-up efforts have been irregular and infrequent at all agencies. Furthermore, at all agencies reviewed, the collection of audit-related debts owed by subgrantees has been inadequate. In addition, although most of the agencies stated they have a policy of charging interest on outstanding debt, very little interest has been collected, and no agency has a policy of charging interest on audit-related debts that are under appeal. Also, I should add that none of the agencies reviewed made any effort to determine whether auditees reduced program performance when repaying audit-related debts.

Question Number 4: What effect would the passage of the Federal Managers' Accountability Act have on the conditions you found regarding accountability for audit-related debts?

Answer: The Federal Managers' Accountability Act and its counterpart in the Senate, the Financial Integrity Act, would provide greater control over the collection of audit-related debts because it would require greater accountability by heads of Federal agencies for the effectiveness of their organizations' systems of internal financial controls. We have already gone on record as a strong supporter of this proposed legislation. As I previously discussed, the most common deficiency found in our review was managements' lack of priority over the collection of audit-related debts. This act is a vehicle to enhance the accountability of Federal officials and requires them to pay closer attention to the quality of internal controls in their agencies.

Especially important is the process that management must go through to assess the adequacy of their systems of internal controls to ensure that they are good enough to protect the Government from the misuse of Federal assets. Equally important is the annual reporting provision that would require agency management to report to the President and the Congress an opinion or an assessment on the adequacy of the

Answer: (cont.) agency's systems of internal controls with plans to correct any weaknesses that were uncovered. This would aid in correcting the problems found relating to the lack of accounting controls and ineffective monitoring over audit-related debts. A commitment to accounting and collection controls over these debts must come from top agency management and this act would get managements' attention to assure strong and effective collection controls.

Question Number 5: Why are most disallowed costs appealed and what do you recommend to reduce appeals which have little merit yet protect those who have valid appeals?

Answer: Grantees and contractors have little to lose by appealing when costs are disallowed. They can retain the disallowed funds during the appeal period with no interest being assessed. So, the possibility of postponing payment at no additional cost becomes an incentive for a grantee or contractor to appeal regardless of the merit of the case.

We believe that agencies should accrue interest on debts under appeal to discourage cases with little merit, and that they should work to streamline the appeals process by handling cases more quickly. Discouraging the weaker and questionable appeals by charging interest would help reduce the unnecessary workload of the appeal boards. It would also allow more time for cases with merit, so that grantees and contractors are not penalized with interest charges for agency delays while pending an appeal decision.

Question Number 6: When Federal funds are misspent by subgrantees, should grantees always be held responsible for these debts?

Answer: No, there may be circumstances totally beyond the control of the grantee, where it may be inequitable to hold the grantee responsible for these debts. Grantees are accountable for the funds spent by their subgrantees and generally Federal agencies should hold the grantees responsible for the payment of the subgrantee audit disallowances. The grantee should assure that funds spent by subgrantees meet the terms and conditions of the grant. However, if the grantee makes a good faith effort to manage the grant funds, and to monitor and audit the subgrantee expenditures on a timely basis the grantee has met its responsibility. If due to circumstances beyond the grantees' control such as fraud by the subgrantee, it would not be equitable to demand repayment from the grantee. If the grantee has not made a responsible effort to manage the grant funds and monitor the subgrantees, then the grantee should reimburse the Federal Government for subgrantees' unauthorized expenditures.

Question Number 7:	How successful have Federal agencies been in using private sector collection agencies to collect Government debts?
Answer:	The only agency that I am aware of that is using collection agencies is the Department of Education in an effort to collect delinquent student loans. However, as I understand, several other agencies currently have this under consideration, such as HUD, VA, and the Social Security Administration. Regarding collection agency effectiveness, Education believes that they have been effective.

Mr. **Brooks**. Do you have any questions at this time, Mr. Horton?

Mr. **Horton**. Yes, Mr. Chairman. Thank you.

Chuck, of the seven agencies which you reviewed, did you find any bright spots?

Mr. **Bowsher**. We did find some agencies, notably, Education, HHS, and Labor, which actually set up the accounts receivables for the audit-related debts. That is about as bright a spot as we found.

Mr. **Horton**. Are you in the process of checking on other agencies?

Mr. **Bowsher**. We are not doing so now.

Mr. **Horton**. Why would you not proceed to check the other agencies?

Mr. **Bowsher**. I think we will review that and consider it.

Mr. **Horton**. It seems to me that it would be helpful to the committee and to the administration if you did have that review as well.

Mr. **Bowsher**. We will give that serious consideration.

Mr. **Horton**. What about the seven accounting systems which you reviewed? Have any of them adopted any of the accounting systems which have been approved by GAO?

Mr. **Bowsher**. We would have to furnish that information for the record. We do not have that information.

[The information follows:]

In this review, we were not looking at entire systems, but rather at how the seven agencies manage receivables arising from audit. This function would be a small part of an agency's accounting systems. However, some of the agencies we audited do have accounting systems which GAO has approved, as follows.

AGENCY	DESCRIPTION
Agriculture	3 of 6 systems approved; Food and Nutrition Service System has not been approved.
Education	2 of 3 systems approved; Departmental Accounting System has not been approved.
HHS	8 of 30 systems approved; audit disallowance procedures approved and current debt collection procedures recently approved.
HUD	1 of 5 systems approved; General Accounting System has been approved.
Labor	10 of 10 systems approved.
Transportation	8 of 10 systems approved; Federal Highway Administration's system has been approved, Urban Mass Transit Administration's system is not subject to GAO approval.
EPA	1 of I system approved.

Some of the systems were approved years ago, and should be submitted to GAO for reapproval due to program and organizational changes over the years.

Mr. **Horton**. How often do agencies turn collection problems over to the GAO or to Justice? Is there much of that?

Mr. **Bowsher**. Steve worked on this and will reply.

Mr. **Sadler**. You are supposed to refer claims, Mr. Horton, if they are over $20,000 to GAO for their consideration and collection, but I do not have any overall statistics available at this point as to how many have and how many have not done so.

Mr. **Horton**. Of those referred to GAO for collection, can you tell us what you did recover?

Mr. **Sadler**. Yes. I do not have that figure readily available, but we could supply it.

Mr. **Horton**. Perhaps, you can tell us what steps GAO takes to recover funds in those cases which are referred to it, how much you could have recovered last year, and how much was referred to you in the last year.

Perhaps you can answer it this way. Is it something which is done frequently, or is it done infrequently?

[The information follows:]

In calendar year 1981, GAO's Claims Group recovered $3,898,828 on debts which agencies referred to GAO for collection. Of this amount, $537,576 was collected by GAO as a result of action by the U.S. Department of Justice.

Over the past few years, the amount collected by GAO has decreased, as more responsibility for debt collection has been returned to executive agencies. In many of those cases which are referred to GAO in a final attempt to collect administratively, the agencies have taken all appropriate actions and the Department of Justice must rule before any results can be obtained. Some agencies now refer cases directly to the Department of Justice, rather than through GAO, which is also reducing GAO's activity in this area.

Mr. **Sadler**. We are finding, based on our audit work, cases wherein amounts over $20,000 were not referred to GAO for collection. I know that there are some which have not——

Mr. **Horton**. That is a concern, is it not?

Mr. **Sadler**. Yes, it is. It is pointed out in our report.

Mr. **Horton**. I guess that GAO and Justice are the only ones who have authority to terminate the debts which are greater than $20,000. Has GAO terminated any?

Mr. **Sadler**. I do not work in that area, but I could get the information and supply it.

Mr. **Horton**. I think it would be helpful.

Mr. **Brooks**. Without objection, the information will be made a part of the record, upon receipt, at this point.

[The information follows:]

GAO has terminated collection on some cases over $20,000, but this happens infrequently. On the average, 30 cases a year may be terminated.

Mr. **Brooks**. GAO has provided examples of cases for seven agencies developed during their review. These agencies are being asked to comment on the examples applicable to their agency and to respond to specific questions.

In addition, all agencies included in this review are being asked to comment on the GAO report. Without objection, these comments and responses will be made part of the hearing record.

[See appendixes.]

Mr. **Brooks**. Sooner or later, someone will do something about this, and we will get it all in shape.

Maybe when Mr. Harper assumes his new responsibilities at the White House, he will want to do something about this. Money can be saved without curtailing services, just by doing it efficiently.

The Chair recognizes Mr. Fascell, the gentleman from Florida.

Mr. **Fascell**. Thank you, Mr. Chairman.

I just want to ask, does GAO have a simple booklet which describes the process, the simple, expedited process, by which GAO considers appeals?

Mr. **Bowsher**. On which side do you mean?

Mr. **Fascell**. I mean those on contract disputes and payments.

Mr. **Bowsher**. I do not believe that there is, Congressman.

Mr. **Fascell**. Will you very briefly describe what that process is? Do you have any idea what it is?

Mr. **Sadler**. No. I do not. I am unfamiliar with it.

Mr. **Fascell**. All right.

Mr. **Brooks**. Will you supply it for the record or for our files? That is, will you supply this information by memorandum so that I may furnish it to Mr. Fascell and to others who may inquire?

Mr. **Bowsher**. Yes; we would be happy to do that.

Mr. **Brooks**. Without objection, that material will be included as part of the the record at this point.

[The material follows:]

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-158766

April 19, 1982

The Honorable Jack Brooks
Chairman, Subcommittee on Legislation
and National Security
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

At the hearing before your Subcommittee on February 24, 1982, concerning our report, "Federal Agencies Negligent In Collecting Debts Arising From Audits" (AFMD-82-32), Mr. Fascell asked about the General Accounting Office's (GAO) role in the process for considering appeals on contract disputes and payments. During the hearing you requested that we send you a letter explaining GAO's role.

In answering this question, we must distinguish between precontract and postcontract award disputes. GAO does have a role in the resolution of preaward disputes; GAO does not have a role in the resolution of postaward disputes. The processes for both types of disputes are described below.

Concerning postaward disputes, the Contract Disputes Act of 1978, 41 U.S.C. §601 et seq. (Supp. III, 1979) gives to the contracting agency's contracting officer the authority to resolve disputes. If the contractor disagrees with the contracting officer, the contractor can appeal to an agency board of contract appeals. The board's determination is subject only to review by the Court of Claims; GAO cannot overturn it.

If a claim against a contractor results from a final agency action on a contract dispute, the Federal Claims Collection Standards will apply. These standards are explained in the aforementioned report. As noted in our report, exceptions to the standards may occur where specific statutes authorize variations. We have provided additional guidance to agencies on the procedures to be used in claims by and against the Government in title 4 of the GAO Policy and Procedures Manual. We have enclosed a copy of this title for your information.

Regarding preaward disputes, GAO has a procedure for handling bid protests or precontract award disputes. The procedure followed is explained in the enclosed booklet which is available to the public.

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Legislation and National
Security Subcommittee

I trust that this information will clarify the concerns raised on February 24, 1982.

Sincerely yours,

Charles A. Bowsher

Comptroller General
of the United States

Enclosures - 2

(Subcommittee note.--The material referred to has been retained in the subcommittee files.)

Mr. Fascell. The reason I ask for this is that we Members of Congress get involved in this on one side or another with respect to appeals which go to GAO. It might be useful to have a document which explains the GAO process.

There are two problems. One is to whom you go in GAO, and what is proper. The second problem is how fast you can get out of there.

Thank you.

Mr. Brooks. This information would be useful. It would be better just writing a letter to GAO and sending them the accusation and the problem.

Mr. Horton. Will the gentleman yield?

Mr. Fascell. Certainly.

Mr. Horton. Is the appeal process consistent? That is, is it a consistent process throughout the agencies, or does each agency have its own form of appeal?

Mr. Jones. Each agency has its own appeal process which it goes through. In our report, when we talk about how time consuming the amount of appeals are——

Mr. Horton. Would it not be better to have a standard for each agency so that there would be one consistent appeal process?

Mr. Jones. They would not like that either.

Mr. Fascell. I tried years ago to standardize the Administrative Procedures Act.

Mr. Bowsher. Let us take a look at that.

Mr. Horton. It seems to me that it would make sense, certainly, in light of your recommendations and the concerns which you have with regard to the abuse of appeals processes to delay the collections.

They could put the screws on them. There are ways to do it.

Mr. Brooks. OMB has to do that.

Mr. Bowsher. I think that is a point. Possibly, the Council of Integrity could look at it, that is, at a more standardized approach. We will look at it, and they can look at it.

Mr. Fascell. That is a great idea, Mr. Chairman.

If you will yield, Mr. Chairman, I will say this. One of the most frustrating complaints which I have heard from business people is the fact that they have to meet deadlines in the appeal process. The Government never does. The Government just outwaits them.

I, personally, participated in cases wherein the petitioner wound up bankrupt waiting for a decision in the case. They were still trying to perform under Government contracts. It is just unbelievable.

As you say, every agency has a different process. There is no way to standardize it under the Administrative Procedure Act.

However, at least, GAO could grab hold of the whole process and make recommendations. If they did that, I think it would be fantastic. It would be the greatest service.

Mr. **Bowsher**. Let us take a look at it. We will talk to OMB about it too.

Mr. **Brooks**. General, I want to thank you, Mr. Sadler, and Mr. Jones for your courtesy in coming down and being with us, for your cooperation, and for the good job you are doing for the people of this country.

Mr. **Bowsher**. Thank you very much, Mr. Chairman and members of the committee.

Mr **Brooks**. Our next witness this morning is Harold I. Steinberg, Associate Director for Management of the Office of Management and Budget.

Prior to assuming his present position, Mr. Steinberg was a partner in the international accounting firm of Peat, Marwick, Mitchell and Co. Mr. Steinberg attended Syracuse University and holds an MBA degree from the New York University Graduate School of Business Administration.

Mr. Steinberg, it is a pleasure to have you with us today. You may now proceed with your prepared statement.

Mr. **Steinberg**. Thank you, Mr. Chairman. You mentioned Ed Harper's big hat. He also has big shoes which I have to fill today. He did tell me before he left that he was indeed sorry that he could not be here.

Mr. **Brooks**. We are glad to hear that he is working early. He was on the telephone at 5:15 a.m.

Mr. **Steinberg**. He does it here too.

Mr. **Horton**. He told me that he was coming back on the Red Eye tonight. Then, he said he has to go to Rutgers University tomorrow.

Mr. **Steinberg**. That is right. He told me that if I want to talk to him, I can meet him at the airport, and we can talk in the car coming in.

Mr. **Brooks**. You may proceed, Mr. Steinberg.

STATEMENT OF HAROLD I. STEINBERG, ASSOCIATE DIRECTOR FOR MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

Mr. **Steinberg**. If I may, Mr. Chairman, I would like to present my statement for the record and make some remarks.

Mr. **Brooks**. Without objection, the statement of the gentleman will be accepted for the record.

You may proceed, Hal.

Mr. STEINBERG. Thank you.

I am pleased to be here today, Mr. Chairman, to discuss the progress which we have made in audit followup systems and collections of debts arising from audit recommendations. We think that the audit resolution and debt collection functions are integral to the administration's efforts to reduce waste and mismanagement and to restore accountability to Federal programs.

Today, the focus is on debt collection and the audit recovery process. I would like to talk about the background because it shows, I think, that we have really come a long way.

It was your committee which led concern over the audit followup process, recognizing that the lack of timely resolution of audit findings meant that money which should be returned to the Government is still in the hands of contractors and grantees.

A number of reports over the years have documented your concern, the GAO reports of October 1978 and January 1981 which Chuck [Bowsher] mentioned, and indeed the Supplemental Appropriations and Rescission Act of 1980, which required that all audits issued on or before March 31, 1981, be resolved by September 30, 1981, and that from there on in, all audits be resolved within 6 months of issuance.

In short, when this administration arrived, we indeed did have a problem, and we decided that we had to act to correct the problem. We believe that we have achieved results.

Let me take you through the actions which we have taken over the last year.

First, when the President created the Council on Integrity and Efficiency, he also directed the heads of the agencies to designate a senior official to be personally responsible for following up on audit findings and recommendations. The President took this extraordinary step because this administration believes that it is essential to have top agency management committed to making sure that appropriate corrective action is taken on the Inspector General's, the General Accounting Office's, and other auditors' findings and recommendations.

I have developed a list of the officials, and it has been provided to the committee.

Second, to insure that the needed changes were made, Ed [Harper], as Deputy Director of OMB and as Chairman of the President's Council, met with the designated followup officials in June. First, he emphasized the President's expectation that they would be personally responsible for audit resolutions and followup.

He reminded them that there was already OMB policy in the form of Circulars A-50 and A-73 which spoke to audit resolutions. What we did then was to discuss the additional attributes of an audit followup system, such as the fact that an agency must assign a high priority to the resolution of audit findings, that the placement of the responsibility for audit findings should be with management, not with the Inspectors General, that there had to be a means to resolve differences between managers and auditors when they occur, that the system had to track resolution through implementation and not stop at the point when it went on the books, and that there was a need for periodic reports on the whole audit followup process through management, particularly focusing on the manner in which open items had been resolved and implemented.

At that meeting, we asked the designated officials to: One, find out whether they had a system back at their agency; two, make a quick evaluation of the system considering the attributes which we distributed and give us their opinion as to whether or not the system met the attributes; and, three, develop plans for corrective actions, in other words, for putting in an improved system or improving the system by the end of the summer.

In the interim, the OMB's staff developed a checklist through which to assess the agencies' audit resolution policies. A copy of the checklist has also been provided to the committee. The checklist was developed so that we could review the agencies' instructions to insure adequate documentation.

Obviously, we did not go in and assess onsite each agency's system.

The completed checklists and the documentation which the agencies developed were then used in meetings with the designated followup officials from each agency and with the IG's. These meetings took place in the early fall of 1981. We discussed our assessment of their system. We provided them with a completed checklist, discussed it at length. If we agreed that there were still deficiencies, we asked them to revise the followup system further.

I would be the first to admit that, in spite of the increased attention which we have given to this system—and which you have given to this system over the past 3 years—there are probably still some major deficiencies in the agencies' systems per se, such things as the lack of a clear requirement for audit resolution within 6 months, failure to track the monetary findings and recommendations, a lack of sufficient detail in their semiannual reports to the agency heads.

One thing which particularly disturbs me is the failure to perform trend analyses of the findings and the disposition of these findings.

We have given this committee a complete list of the deficiencies which we found as a result of the review.

I guess, when you get down to it, the bottom line is the results or what is actually happening with the audit findings. The meetings were used to review more than just the system. We also took a look to see how the agencies would be faring in terms of the September 30, 1981, legislative guideline. The results were reported to you in December by the Director.

We think that the September 30 results were quite significant. From a position where, in January 1981, the GAO reported that there were $1.65 billion in unresolved audits over 12 months old, we were able to report in September 1981 that there was only $218 million unresolved for more than 6 months.

The initial focus, Mr. Chairman, on resolving old audits complements Congress and the GAO's concerns about prompt resolution, but as we sit here today, we know that recoveries are the ultimate goal. The final measure of audit followup is not resolution. It is getting the money in the bank.

The reviews and the emphasis on audit followup, which we did, spotlighted two additional concerns we have which go beyond the initial interest in improving the timeliness of resolution. We will talk about the second here this morning; namely, debt resolution. I will come back to that. The first is the quality of the audit resolution taking place in the agencies.

The emphasis on prompt resolution obviously runs the risk of producing poor resolution decisions, that is, favoring the auditee over the Government. In fact, I think the percentage is something like 35 percent, that is, 35 percent of the resolutions are sustained and eventually go into the recovery system.

I can think back to my days as a private auditor. If only 35 percent of my recommendations were sustained, I would not be in business very long.

Therefore, we asked the agencies to focus on this and see what they can do to improve the quality of the resolutions made. We have discussed with the General Accounting Office the possibility of a review in this area with emphasis on decisions detrimental to the Government.

We believe—although we cannot prove it—that there are several problem areas. No. 1 would be confusing requirements imposed on the auditees, which are basically not attainable or are difficult to attain.

No. 2 would be some unclear audit instructions resulting in improper audit recommendations. No. 3 would be leniency of program officials. No. 4 would be problems of earlier precedent-setting decisions favoring the auditee.

With regard to debt collection, as you know, debt collection is a major initiative of this administration. The President has directed an aggressive program to pursue and recover $33 billion in delinquent debts owed. He directed a two-pronged effort involving administrative initiatives and legislative initiatives.

The 24 agencies which account for 95 percent of the debt owed have begun comprehensive programs to improve their credit management and debt collection programs, such things as assigning the responsibility within the agency for collecting debt to a specific individual, establishing the information systems to provide the source and the age of our receivables, relying upon automation to the greatest extent possible.

We cannot, we do not think, just do it through administrative means. The administration has asked Congress for the legislation to eliminate some of the disincentives which presently exist in the Government's collection system, one of which you and the Comptroller General were talking about; namely, while the agencies are permitted to charge interest, they have felt reluctant to do so because in the appeals process, the interest seems to be knocked down, to disappear, and so forth.

One of the things which we have asked for in the legislation is that the agencies be directed to accrue the interest from the moment the audit disallowance is entered, not from the conclusion of the appeal process.

Another type of tool which we want was also mentioned in Chuck's [Bowsher] recommendation. That was to advise credit bureaus that someone owes the Federal Government money.

Other types of legislative initiatives would provide for increased efficiency and effectiveness in the way the Government goes about granting and servicing the credit and collecting debt.

We hope that the Congress will act without delay in the debt collection proposal. We are counting on it for approximately $500 million of our projected collections. By itself, that is more than the $374 million which Chuck mentioned.

That is very important. If we cannot collect it or we cannot get the legislation, obviously, we will have to look elsewhere for budget savings.

One of the things we learned from working on the debt collection project and obtaining the receivables data for the first time was that the amount of debts resulting from audit findings is really low by comparison to the $218 billion in total assets.

For instance, HUD is owed something like $14.5 billion. Their audit-related receivables is in the range of $102 million, or less than 1 percent.

That fact has compelled us to put our emphasis on collection of the total receivables and to address the audit findings in the context of the general program debt. This does not mean that we ignore the audit findings. In fact, we have expanded the definition of audit followup and desired information system requirements to provide for tracking and monitoring what is happening from finding, through resolution, to implementation.

We know that in CETA, for instance, whereas in 1980 they had recovered only about $6 million of their audit disallowances, in 1981 it was up to $11 million. I believe that they will be collecting $28 million this year.

HUD has put their audit disallowances into a nationwide accountability program through which they are monitoring the collection of the sustained audit findings and holding the regional administrators and the deputy area office managers personally responsible.

HHS, which was mentioned by the Comptroller General, has focused on the debts by the medicare contractors in the States resulting from audit disallowances. They have not only placed them under accounting control, but they have taken the additional step of directing that the operating units charge the interest on the audit findings.

In conclusion, Mr. Chairman, I would say that we believe that audit findings, audit resolutions, and audit followup are extremely important. Indeed, they are another step in our efforts.

We are meeting this afternoon with designated followup officials to review the progress in the audit resolution process. We will share with them unique approaches which we found from the fall's reviews. We will preview revisions to the OMB circulars. GAO will be making a presentation on the results of the review which they just reported to you this morning.

In sum, we are keeping the need to focus on audit findings and audit resolutions before the agencies. We will be asking for their reports and the status of unresolved audits over 6 months old as of the end of March. We will also be asking how the resolutions were made.

We think that this continued work with the debt collection officials, with the Inspectors General, and with the designated follow-up officials will enable us to keep this at the proper level of attention so that we can continue to get the results which we feel are appropriate.

That concludes my remarks, Mr. Chairman. I would be glad to take questions.

[Mr. Steinberg's prepared statement follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

FOR RELEASE ON DELIVERY
Expected at 9:30 a.m.
Wednesday, February 24, 1982

Statement of Harold I. Steinberg
Associate Director for Management
Office of Management and Budget
Before the House Government Operations Committee
Subcommittee on Legislation and National Security

Mr. Chairman and Members of the Committee:

I am pleased to appear before you to discuss the progress made in resolving problems associated with audit follow-up systems and the colleciton of debts arising from audit recommendations. The areas of audit resolution and debt collection are integral to this Administration's efforts to reduce waste and mismanagement in Government and to restore accountability in Federal programs.

Background

The House Committee on Government Operations has been concerned for some time that the lack of timely audit resolution means that monies which should be returned to the Government may be left in the hands of contractors and grantees, and that savings which could accrue to the Government by improved operations may not be realized. A Report by the General Accounting Office in October 1978 began to scope the problem.

The Supplemental Appropriations and Rescission Act of 1980 echoed the concern, and required that all audits issued on or before March 31, 1981, be resolved by September 30, 1981, and that all future audits involving questioned costs be resolved within six months. Another GAO report, issued in January 1981 reiterated the problem. In short, when this Administration arrived, the problem was serious.

Mr. Chairman, this Administration shares your concern, which was again reiterated in a November 1981 report, has acted to correct the problem, and achieved results.

Designation of Audit Follow-up Officials

If I may, I would like to describe what we have done. When President Reagan created the Council on Integrity and Efficiency to provide leadership to the Governmentwide anti-fraud and waste effort, he also directed the heads of departments and agencies to designate a senior management official to be personally responsible for following-up on audit findings and recommendations. The President took this extraordinary step because the Administration believes it is essential to have top agency management committed to making sure that appropriate corrective action is taken on the Inspectors General's, the General Accounting Office's, and other auditors' findings and recommendations. The designation of follow-up officials recognizes that the Administration's anti-fraud and waste program will fall short of its objectives if auditors uncover waste and inefficiencies and then management fails to follow-up with corrective action. (A list of these officials is being provided to the Committee).

In order to ensure that the designation of these officials was more than a paperwork exercise and would result in the needed changes, the Deputy Director of OMB met with these individuals on June 25, 1981, to emphasize the President's expectation that they would be held personally responsible for audit resolution and follow-up in their departments and agencies. We briefed them on the then existing policy foundation of OMB Circulars A-50 and A-73 which provided for:

- procedures for resolving major disagreements between audit and program officials;
- determinations of agency actions within six months;
- periodic evaluations of agencies' audit resolution systems; and
- semi-annual reports to the head of an agency.

We also stressed that the attributes of audit follow-up systems -- for which they were being held responsible -- went far beyond these requirements to include:

- the agency assigning a high priority to the resolution of audit findings;
- the placement of responsibility for audit follow-up on management instead of the Inspector General.
- specification of a means to resolve differences between managers and auditors;
- the need for systems which track findings and recommendations through resolution to implementation; and
- the need for periodic reports on the status of audit findings and on the manner in which open items have been resolved and implemented.

(A complete list of these attributes is being provided to the Committee).

The designated officials were then asked to evaluate their agencies' follow-up systems in light of these attributes, to provide OMB with descriptions of their systems by late July, and to develop plans for corrective action by the end of the summer.

Review of Agency Follow-up Systems

In the interim, OMB staff developed a checklist with which to assess the agencies' audit resolution and follow-up systems. (A copy of the checklist is provided for the Committee). The checklist was designed to review the agencies' instructions for their audit follow-up systems to ensure that they were adequately documented rather than to assess the systems themselves. The completed checklists, and the documentation submitted by the agencies, were used as a basis for meetings with the designated follow-up officials and the agency Inspectors General in the fall of 1981. Following those meetings, we provided each of the follow-up officials with copies of the completed checklists to use as necessary in revising agency instructions on audit resolution and follow-up.

In spite of the increased attention which has been given to audit resolution over the past two years, we found major deficiencies in agencies' descriptions of their follow-up systems including:

- lack of a clear requirement for audit resolution within six months;
- failure to track non-monetary findings and recommendations;

- lack of sufficient detail in the required semi-annual reports to agency heads; and
- failure to perform trend analyses of findings and the disposition of those findings.

(A complete list of the major deficiencies noted in this review is being provided to the Committee).

Resolution of Audits Over Six Months Old

We also used these meetings with the follow-up officials to review the agencies' resolution of audits in accordance with the Supplemental Appropriations and Rescission Act -- to determine how many and what value could be attached to the number of audits unresolved for over six months. We used these meetings for this review because a significant measure of the adequacy of agency audit resolution and follow-up systems is the prompt resolution of audits.

As Director Stockman reported to you in December, the twenty-one agencies reporting to OMB in early October 1981 had unresolved audits over six months old totalling only $218 million. That is significant progress compared to the $1.65 billion in unresolved audits over twelve months old reported by the GAO in January 1981. In fact, seven of the twenty-one agencies reported that there were no unresolved audits over six months old as of September 30, 1981. (A table illustrating this progress in being provided to the Committee).

This initial focus on the resolution of older audits complements the Congress' and the GAO's concern about prompt resolution of audit findings. By definition, audits are usually unresolved on the day they are issued by the Inspector General or other audit staff. Thus, focusing on the total number of unresolved audits at any given time does not provide an accurate picture of the progress made in audit resolution.

The final measure of audit follow-up is not resolution. Actual dollar recoveries are the ultimate goal. The sustaining of questioned costs totalling $650 million by the civilian agencies during the second half of fiscal year 1981 is the first step toward ensuring that future recoveries and savings are achieved. The $355 million in recoveries reported by the IGs in this period also indicates the increasing effectiveness of the audit follow-up systems.

Remaining Concerns on Audit Follow-up

Our reviews and emphasis on audit follow-up systems have spotlighted two special concerns which I'd like to share with the Committee:

- the first is the quality of the audit resolution taking place in the agencies; and
- the second, which the Committee is addressing today, is the collection of debts arising from audit findings and recommendations.

With regard to the quality of audit resolution, as long as there is an emphasis on prompt resolution of audit findings and recommendations, we run the risk of poor resolution decisions. These are resolution decisions which favor the auditee over the Government. In some agencies, only 35% of the auditors' findings and recommendations are being sustained by management at this time.

We have asked the agencies to focus on the condition and believe the additional audit follow-up data they will collect will stimulate them to attempt to improve the quality of resolutions. Also, we have been talking with the General Accounting Office about the possibility of conducting a review of the resolution decisions in the agencies, and particularly those that are detrimental to the Government. We suspect, but cannot at this time substantiate, that the problems include: confusing requirements for the auditee that are difficult to achieve; unclear audit instructions that cause the auditor to make mistakes; leniency of program officials; and the problems of earlier, precedent, decisions which have favored the auditees.

Debt Collection

On the second issue, debt collection, as this Committee knows, debt collection is a major initiative of this Administration. The President has directed that an aggressive program be pursued to recover the $33 billion in delinquent debts owed the Government. The program is a two-pronged effort, consisting of administrative and legislative initiatives.

On the administrative side, the 24 agencies that account for over 95 percent of the debts owed the Government have begun comprehensive programs to improve their credit management and debt collection practices by initiating such tasks as assigning the responsibility for collecting the debt to specific individuals, and establishing the information systems that provide the source and age of the receivables. On the legislative side, the Administration has asked Congress for legislation needed to eliminate some of the disincentives that presently exist in the Government's debt collection process; to make available essential tools and techniques used effectively in the private sector; and to provide for increased efficiency and effectiveness in the way the government grants and services credit and collects debt. We hope the Congress will proceed to enact the legislation without delay. We have counted on it to obtain approximtely $500 million of the projected debt collection, and if it is not available we will have to look elsewhere for budget savings.

One thing we learned from obtaining the receivables data for the first time is that the amount of debts resulting from audit findings is low in comparison to the $218 billion in total debts. For instance, the total monies owed HUD is $14.5 billion, while the audit debts are $102 million. Thus, we concluded that it would be improper to emphasize collection of audit disallowances at the expense of other debt. Rather, the agencies should address audit recoveries within the context of general program debts.

This does not mean that the agencies will ignore attempting to collect audit disallowances; they will only place them in context. For instance, the agencies' reports to OMB disclose the following:

- In the CETA program the Department of Labor had recovered only $6.2 million in audit disallowances through fiscal 1980. In FY 1981, $11.7 million in collections were made with an estimated $28 million to be collected in FY 1982.

- The collection and resolution of sustained audit findings is an important element in HUD's Debt Collection Program. HUD has set up a nationwide Accountability Program in the 10 regional and 98 subregional offices which will focus direct responsibility for monitoring the collection of sustained audit findings at the Deputy Regional Administrator, and Deputy Area Office Manager level.

- The Inspector General in Health and Human Services (HHS) brought to our attention the problem that debts by Medicare contractors and States, resulting from audit disallowances, are not booked as a receivable by the Department. The Inspector General estimates the amounts to be $179 million and $70 million, respectively. The debt collection officials in HHS have just agreed to record these audit disallowances, thereby placing them under accounting control. HHS is also issuing a directive to its operating units this month instructing them to charge interest on audit disallowances.

Next Steps

In concluding my formal remarks, Mr. Chairman, I would like to briefly outline where we go from here.

We are meeting with the designated audit follow-up officials this afternoon to review the progress which has been made in audit resolution, to share with them some of the unique approaches to audit resolution which we encountered last fall in our review of agencies' systems, to preview some of the revisions to the OMB Circulars on audit resolution, and to hear from the GAO on the nature of their current assessment of audit resolution. The purpose of the meeting is to both remind these officials of the importance which we place on audit follow-up and to ensure that the progress which we saw in the last year is not transitory.

We will, once again, ask those officials to provide us with a report on the status of unresolved audits over six months old as of March 31, 1982, and with a report on the nature of resolution decisions made during the six month period October 1, 1981, through March 31, 1982. We will share these reports with this Committee when they are available.

We also continue to work with the agency debt collection officials to ensure that agencies' records on the collection of debts owed the Government accurately reflect the age and status of all debts.

Finally, we continue to work with the Inspectors General in the President's Council on Integrity and Efficiency to ensure that the IG's reports to the Congress, the follow-up officials reports to OMB, and all other reports on the nature of auditors findings, recommendations, and subsequent agency actions to implement those recommendations are using the same definitions.

ATTACHMENT 1

DESIGNATED AGENCY FOLLOW-UP OFFICIALS FOR ANTI-FRAUD AND WASTE EFFORTS

Mr. Richard E. Lyng
Deputy Secretary
Department of Agriculture
Washington, D. C.

STOP 209

Ms. Arlene Triplett
Assistant Secretary for Administration
Department of Commerce
Washington, D. C.

STOP 206

Mr. Spencer Lott
Attorney-Advisor
Community Services Administration
1200 19th Street, N. W.
Washington, D. C.

STOP 277

Mr. Joseph H. Sherick
Assistant to Secretary of Defense
  for Review and Oversight
The Pentagon, Room 3N1081
Department of Defense
Washington, D. C.

STOP 103

Mr. Kent Lloyd
Deputy Under Secretary
Department of Education
Washington, D. C.

STOP 113

Mr. William S. Heffelfinger
Assistant Secretary for Management
  and Administration
Department of Energy, Rm. 4A253
Washington, D. C.

STOP 6114C

Mr. John Horton
Assistant Administrator for
  Administration
Environmental Protection Agency
Washington, D. C.

STOP 460

Mr. Ray Kline
Deputy Administrator
General Services Administration
Washington, D. C.

STOP 29

Mr. Dale W. Sopper
Assistant Secretary for Management
and Budget
Department of Health and
Human Services, Rm. 510A Humphrey
Washington, D. C.

STOP 367

Mr. Donald I. Hovde
Under Secretary
Department of Housing and
Urban Development, Rm. 1011
Washington, D. C.

STOP 98

Mr. J. Robinson West
Assistant Secretary for Policy,
Budget and Administration
Department of Interior
Washington, D. C.

STOP 43

Mr. R. T. Rollis, Jr.
Special Assistant to the
Administrator
International Development
Cooperation Agency, Rm. 3927 State
Washington, D. C.

STOP 27

Mr. Edward Schmultz
Deputy Attorney General
Department of Justice
Washington, D. C.

STOP 219

Mr. Malcolm Lovell
Under Secretary
Department of Labor
Washington, D. C.

STOP 205

Ms. Ann Bradley
Acting Associate Administrator
National Aeronautics and
Space Administration
Washingotn, D. C.

STOP 85

Mr. Loretta Cornelius
Deputy Director
Office of Personnel Managment
Washington, D. C.

STOP 227

Mr. Richard T. Kennedy
Under Secretary for Managment
Department of State
Washington, D. C.

STOP 27

Mr. Kenneth Klinge
Special Assistant to the Secretary
Department of Transportation
Washington, D. C.

STOP 330

Ms. Cora P. Beebe
Assistant Secretary for Administration
Department of the Treasury
Washington, D. C.

STOP 223

Mr. Robert Nimmo
Administrator
Veterans Administration
Washington, D. C.

STOP 73

Mr. Robert A. Turnbull
Associate Deputy Administrator
Small Business Administration
Washington, D. C.

STOP 71

ATTACHMENT 2

ATTRIBUTES OF A COMPLETE FOLLOW-UP SYSTEM

- Agencies assign a high priority to the resolution of audit findings.
- Minimum qualifications and independence requirements for follow-up officials.
- Systems for tracking and reporting outstanding findings and disposition thereof established and maintained.
- Specification of when audit findings can be considered resolved and the appropriate evidence required.
- Specification of a means to resolve differences between managers and auditors.
- Clearly defined policies for resolving an audit finding in the grantee's favor, including required documentation.
- Time limit for resolution of audit findings.
- Procedures for resolving audit findings still outstanding past the required timeframe.
- System continues to track items through implementation, rather than stop at resolution.
- Specification of when audit findings can be considered implemented and the evidence required.
- Periodic reports on the status of audit findings and of the manner in which previously open items have been resolved and implemented.
- Analysis of audit findings, consideration of trends and systemic causes, and initiation of actions to correct causes.
- Inclusion of performance in resolving audit findings in the personnel rating system.
- Periodic evaluation of the audit follow-up system.

Checklist for Follow-up Systems Analysis

	YES/NO	COMMENT 1/
A. Policy Requirements		
1. Do agency policies clearly require follow-up to findings of IG and GAO audits or reviews?		
2. Do agency policies clearly require a written determination on all IG findings within six months?		
3. Do agency policies clearly emphasize the need to respond to GAO reports within allotted time frames?		
4. Do agency policies require implementation of recommendations with which agency management concurs?		
5. Do agency policies clearly require an appropriate separation of responsibilities between the IG, the program officials, and the audit follow-up officials?		
B. Organizational Responsibilities		
1. Are follow-up systems established at:		
a. Agency headquarters level?		
b. Bureau level (sub-agency)?		
c. Regional level?		
d. Field activity level?		
2. If systems exist at several organizational levels, are reports/findings tracked simultaneously at different levels?		
3. Are there special audit resolution committees established for the follow up system?		
a. Is the membership clearly identified?		
b. Are the committees' functions clearly defined?		

ATTACHMENT 3

1/ Enter reference to documents on follow-up.
Additional comments on a separate sheet.

YES/NO COMMENT 1/

C. Designation of Follow-up Officials

1. Have official(s) for audit follow-up been designated as required by A-73 (8b(1))? ____________

2. Has an official for follow-up on IG and GAO recommendations been designated as required by President Reagan's March 26 memorandum? ____________

   a. Provide the name, title, address, and phone number of the individual designated: ____________________
   ____________________.

3. Has an official responsible for liaison with OMB on GAO reports been designated as required by A-50 (7)? ____________

4. Are the functions and responsibilities of each of these officials clearly defined? ____________

D. Definitions

1. Have all audit terms been defined (e.g., questioned costs, disallowed costs, suspended costs, findings, etc.)? ____________

2. Have follow-up terms been defined (e.g., resolution, closed audit, implementation, etc.)? ____________

3. Have timing terms been defined (e.g., prompt, responsive, days, etc.)? ____________

4. Have organizational terms been clearly identified (e.g., program managers, audit office, audit resolution committees, etc.)? ____________

1/ Enter reference to documents on follow-up.
Additional comments on a separate sheet.

	YES/NO	COMMENT 1/
E. System for Tracking and Reporting		
1. Does the agency system for tracking and reporting audit follow-up include the following:		
a. External audits		
i contract?		
ii Inspector General or equivalent?		
iii other?		
b. Internal audits		
i GAO?		
ii Inspector General or equivalent?		
iii other?		
2. Is there a mechanism for ensuring that all reports (or findings) are entered into the system and tracked through to implementation?		
3. Are the following categories of information included in the system:		
a. Disallowed costs?		
b. Questioned costs?		
c. Organizational recommendations?		
d. Personnel/staffing recommendations?		
e. Systems recommendations?		
f. Regulatory/legislative recommendations?		
h. Hardware issues (e.g., computer security, stockpiles, physical security)?		
4. Does the system provide for a stratification of findings by characteristics such as:		
a. Dollar thresholds?		
b. Program importance/sensitivity?		
c. Repetition of findings (i.e. how many prior audits have been made with the same recommendations)?		
d. Red flagging of serious problems (e.g., is there an immediate loss of Federal funds, occurence of fraud or other illegal acts, exposure to press/Congress/general public of gross mismanagement)?		

1/ Enter reference to documents on follow-up.
Additional comments on a separate sheet.

YES/NO COMMENT 1/

5. Are there appropriate time limits built into the system as required by A-73 and A-50:
   - a. Six month deadline on written determinations of all findings? ______
   - b. Thirty day report to OMB when corrective action has been completed on certain GAO findings? ______
   - c. Sixty day report to Government Operations Committees of House and Senate on certain GAO findings? ______
   - d. Report to Senate and House Appropriations Committees when appropriation request is submitted sixty days after GAO report? ______

6. Does the system have a tickler system which ensures that deadlines are met by appropriate officials? ______

7. Does the system provide for time limits internal to the agency to ensure that the statutory and regulatory time limits noted above are met? ______

8. Does the system provide a method for negotiating extensions of due dates on GAO reports (A-50(3))? ______

F. Audit Resolution

1. Is the evidence required to substantiate resolution and implementation clearly defined? ______

2. Is there an established, and well documented, procedure for appeals by auditees of decisions made by auditors or program officials? ______

3. Is there an established, and well documented, procedure for elevating major disagreements between auditors and program officials for resolution? ______

4. What procedure is used to resolve these differences:
   - a. Elevation to follow-up official? ______
   - b. Elevation to audit resolution committee? ______
   - c. Elevation to next organizational level in department? ______
   - d. Other (explain)? ______

1/ Enter reference to documents on follow-up. Additional comments on a separate sheet.

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	YES/NO	COMMENT 1/
G. Reporting Requirements		
1. Does the system provide for semi-annual reports to the agency head on:		
a. Status of audit reports over six months old?		
b. Number of reports/findings resolved?		
c. Dollar amount of reports/findings resolved?		
d. Dollar amount of recoveries?		
e. Number of recovery actions?		
f. Dollar amount of offsets?		
g. Number of offsets taken?		
h. Number of demands for payment?		
i. Dollar value of demands?		
j. Number of findings written off?		
k. Dollar value of findings written off?		
2. Does the system provide for periodic reports on:		
a. Resolutions?		
b. Planned implementations?		
c. Implementations?		
d. Implementations postponed?		
3. Is there an established system for reporting outside of the agency:		
a. Statement to OMB (within six months) on certain GAO reports as required by A-50?		
b. Reports covered under Section 236 of the Legislative Reorganization Act of 1970?		

1/ Enter reference to documents on follow-up. Additional comments on a separate sheet.

YES/NO COMMENT 1/

H. Trend Analyses

1. Does the system provide for an analysis of audit findings for trends and systemic issues? ____________________

2. Are these analyses conducted on a periodic basis? ____________________

3. Which organization is responsible for conducting these analyses? ____________________

4. Do the analyses for trends and systemic issues include the development of recommendations and plans for improvements? ____________________

5. Are those recommendations/plans also tracked by the follow-up system? ____________________

I. Flowchart of System

1. Does the documentation for the follow-up system include flow charts? ____________________

2. Are all follow-up procedures included in the flow charts? ____________________

3. Are all the loops appropriately closed? ____________________

J. Implementation of System

1. Is the follow-up system completely implemented? ____________________

2. If not, is there a timetable for implementation? ____________________

3. Can those parts of the system which are implemented function independently of the whole system? ____________________

4. Are there crucial characteristics of the system which are not implemented? ____________________

   a. If yes, identify: ____
   ____.

1/ Enter reference to documents on follow-up.
Additional comments on a separate sheet.

ATTACHMENT 4

Major deficiencies commonly noted in the agencies' descriptions of audit follow-up systems:

- lack of clear requirement for a written determination (i.e. resolution) on all audits within six months;
- lack of definition of terms used in the written instructions and orders;
- failure to include non-monetary recommendations in audit follow-up system;
- failure to stratify findings in the audit resolution system to focus attention on the most significant and sensitive findings;
- lack of detail in the required semi-annual reports to agency heads;
- failure to require or conduct trend analyses of the findings tracked in the system and the disposition of those findings; and
- lack of a clearly defined requirement for evaluations of the audit follow-up and resolution system.

Attachment 5

UNRESOLVED AUDITS

Agency	March 31, 1981 Total		September 30, 1981 Total		September 30, 1981 Over Six Months	
	Number	Value $millions	Number	Value $millions	Number	Value $millions
Agriculture	598	$ 409.0	147	$ 58.6	29	$ 36.4
AID	69	$ 11.8	61	$ 16.4	19	$ 12.0
Commerce	1,186	$ 125.0	605	$ 100.1	287	$ 56.9
CSA	602	$ 45.7	N/A	N/A	255	$ 31.0
Defense	N/A	N/A	29	N/A	1[1/]	$ 1.5
Education	2,535	$ 68.0	3,367	$ 68.0	1,804	$ 17.4
Energy	346	$ 10.2	389	$ 13.2	55	$ 2.0
EPA	973	$ 126.7	418	$ 149.0	54[2/]	$ 30.1
GSA	471	$ 80.4	180	$ 44.2	0	$ 0
HHS	1,937	$ 227.1	1,406	$ 104.9	0	$ 0
HUD	3,251	$ 282.6	2,347	$ 95.9	124	$ 8.3
Interior	193	$ 46.0	121	$ 22.7	39	$ 5.7
Labor	794	$ 302.9	137	$ 79.6	0	$ 0
NASA	285	$ 51.6	224	$ 41.5	5[3/]	$ 2.6
SBA	N/A	N/A	29	$ 5.2	0	$ 0
State	13	$ 1.0	12	$ 6.6	3	$ 0
Transportation	339	$ 390.0	146[4/]	$ 79.0	12	$ 14.8
VA	35	$ 0.5	14	$ 3.9	0	$ 0

[1/] Internal audits only.

[2/] The IG received management reponses on 37 of these reports prior to 9/30/81. Those responses are being evaluated for possible concurrence by the IG or referral to the Audit Resolution Board.

[3/] Only those audits for which NASA has retained audit cognizance.

[4/] Only audits with unresolved questioned costs. An additional 57 audits were unresolved containing $270 million classified as other dollar benefits.

Mr. Brooks. I want to thank you very much.

I have a few questions to ask you now, and I will submit some others for the record, Mr. Steinberg, if that is acceptable to you.

The President's Council on Integrity and Efficiency reported $388 million in audit recoveries for the second half of fiscal year 1981. Are you satisfied with the accuracy of the audit recovery figures reported for the Department of Transportation and the General Services Administration?

Mr. Steinberg. Yes, Mr. Chairman. One of the problems we have had as we have started to work with the Inspectors General, asking them to report these figures, is the matter of definitions of such things as audit recoveries, costs sustained, questioned costs, and so forth.

We have set up within the council an evaluation committee. Its main focus is to define the various categories which they have agreed should be reported and then to distribute the definitions to the Inspectors General so that they can record the information and provide it to us.

We think we are making progress in that area. The evaluation committee will be reporting back to the council at the March meeting. The two concerns which they have are—rather, the two things of which they have to be careful—are to provide definitions to the agencies so that the agencies do not go through what, I guess, you would consider duplication of their accounts; and more important, to provide definitions so that the agencies can provide us with information within the context of their own programs.

Mr. Brooks. What happened was that the Department of Transportation said that they had $190 million in audit recoveries, however, $139 million were costs to be avoided in the future. That is the kind of thing that needs to be defined for them.

Mr. Steinberg. That is right.

Mr. Brooks. It is one thing to say that I am going to avoid spending $100 billion in the future because I am not going to do it—does that make me a hero? It means nothing.

You need those definitions. The media has raised some serious questions about GSA's claims too. Wouldn't you agree that the $2 billion in savings claimed by OMB is overstated?

Mr. Steinberg. No, Mr. Chairman. The DOT claim, which is the one you brought up and the one on which the media focused, of $190 million includes the $139 million which are canceled grants, deobligations of funds which had already been obligated. These are a little bit more precise than the $1 billion I am going to save in the future.

We looked and you can look in their semiannual report. There are such things in there as [UMTA] Urban Mass Transportation Administration grants which they had looked at and some specific projects which were mismanaged; $28 million was deobligated. Management agreed to that.

There was another one in which a major transit authority was not maintaining acceptable bus maintenance programs; $19½ million was rejected by UMTA management on the basis of an OIG audit. These are specific savings.

It is the definitions with which we are all having trouble. They considered canceled grants and deobligations as cost recoveries. We will be straightening that out.

Mr. BROOKS. What requirements do you intend to incorporate in the revised circular on accounting and collection controls once a debt has been established?

Mr. STEINBERG. We will put in there a requirement that the agreed-to debt be entered into the accounts receivable system. That will be in the revised circular.

Mr. BROOKS. What can the OMB do to be better informed on what agencies are doing to implement audit resolution and debt collection requirements?

Mr. STEINBERG. As I indicated during my testimony, I think that we have a number of mechanisms. We have our designated audit followup officials, with whom we meet on a regular basis as a group. We also meet with them individually, along with the IG's who are very much involved in the audit followup process. We ask for reports from them every 6 months. We have constant contact by telephone and review their materials as they send them in to us. Finally, we have the budget review process.

Mr. BROOKS. What can be done to make Federal agency management charge and collect interest on delinquent debts?

Mr. STEINBERG. I would like to have the legislation for that, Mr. Chairman. As I indicated, it has been introduced in both Houses of Congress, as I think you know. It is part of the Debt Collection Act of 1981 to require the agencies to start to charge interest. If the legislation is passed, we will direct the agencies to start charging the interest 30 days after the grantee or the contractor is notified that the questioned cost has been sustained against them. Therefore, for the prompt payment to be consistent and fair, the Government should have a similar 30-day grace period or period of notification.

Mr. BROOKS. Good. Can you live with that?

Mr. STEINBERG. Do you mean the 30 days?

Mr. BROOKS. Yes.

Mr. STEINBERG. I would like to have the extra 15-day grace period, but if you give it to us, we will go for the 30 days.

[Submissions to additional questions by Chairman Brooks follow:]

Additional Questions
from Chairman Brooks
Audit Follow-up Hearing
of February 24, 1982

1. What are the impediments departments and agencies face in collecting audit-related debts?

A. Last May, the Administration asked Congress for a number of legislative changes needed to strengthen debt collection in the Federal Government, including the charging of interest and penalties on delinquent debts owed the Government. This change will be a clear statement of the intent of Congress that interest and penalties are chargeable on debts owed the Government, including those generated from audit disallowances.

Senate Bill S. 1249, introduced by Senator Charles Percy on April 27, 1981, and House Bill 4614, introduced by Congressman George Danielson on September 29, 1981, both include this provision. If enacted, auditees would be informed of the audit disallowance and instructed to return the disallowed funds within 30 days. If the funds are not repaid within 30 days, the auditee would be charged interest. This will provide an incentive for the auditee to repay and will reduce the number of frivolous appeals by auditees. At the same time, the charging of interest and penalties will compensate the Government for the loss of the funds during the period of delay.

2. Will the revised OMB circular address the need for a standard procedure to establish a debt once agency management agrees that costs questioned by auditors are not allowable?

A. The revised Circular is expected to provide instructions for the proper recording of accounts receivable when audit-related debts are determined. Procedures for collecting such debts will be addressed separately as part of our debt collection efforts.

3. What would you recommend to reduce the number of appeals of audit disallowances where there is little merit to the appeal yet protect those with valid appeals?

A. Proposed legislation would provide for interest on disallowed costs. This will provide an incentive for the auditee to repay and will reduce the number of frivolous appeals by auditees. At the same time, the charging of interest and penalties will compensate the Government for the loss of the funds during the period of delay.

4. Do you believe a grantee should be held accountable when Federal funds have been misused by its subgrantee?

A. Yes.

Mr. Brooks. Do you have any questions, Mr. Horton?

Mr. Horton. Yes. Thank you, Mr. Chairman.

First, I want to say to you, Harold, that I think you have done an excellent job, and OMB is doing an excellent job, in this matter. I think you are to be commended for it.

The fact that we are having this hearing and are expressing the concerns which we have does not mean to say that we are not pleased. We are merely taking an active interest.

Mr. Steinberg. Thank you.

Mr. Horton. Is this within your province? In other words, are you personally responsible in this area?

Mr. Steinberg. Yes. It is under the OMB management side.

Mr. Horton. I mean from the standpoint of what you do personally. Is this something which you work on?

Mr. Steinberg. Very much so. I might add, though, that I have with me Melissa Allen and John Lordan, who are two capable helpers, but I very definitely get involved.

Mr. Horton. The point is that you do get yourself personally involved, and you are personally familiar with what is being done. Regarding the instances which you talked about, they are matters which come to your personal attention.

Mr. Steinberg. Yes.

Mr. Horton. The staff called my attention to the fact that this GAO report is dated January 22, 1982. As I understand it, that report only went through June, so it did not really cover the full calendar year of 1981. Is that correct?

Mr. Steinberg. I am not familiar with that report.

Mr. Horton. This is the report. You have not seen this yet. Is that right?

Mr. Steinberg. That is right. Is that the one dated 2 days ago?

Mr. Horton. Yes.

Mr. Steinberg. No. We have not seen it.

Mr. Horton. You will get a copy of it.

Mr. Steinberg. I would like to say that I listened as Chuck was describing the eight recommendations. Of the eight recommendations in there, five or six of them we are planning to cover in the A-50/A-73 revisions which we have in progress right now.

We believe we need the proposed debt collection legislation to do two of them. They are: To charge interest and advise credit bureaus of people who are not paying their debts, which was the other one he mentioned.

The third one which affects the subgrantees is one which we will have to look at more.

Mr. Horton. I think it would be helpful. That was one of the questions I was going to ask you on those recommendations.

At the end of his statement he said that he recommended that the Director of OMB and OMB incorporate the recommendations in the management circular on audit resolutions which is currently being revised, and then followup should be done to make sure that agencies are complying.

I think it would be helpful to us if you would analyze the recommendations and give us a report in writing for the subcommittee as quickly as you can do that. We will include that in our hearing record.

Mr. **Steinberg**. I would be glad to do that.

Mr. **Brooks**. Without objection, the material when received will be made a part of the record at this point.

[The material follows:]

1.	Recommendation:	"Require a written determination of the allowability of all questioned costs within 6 months of audit report issuance."
	Comment:	We agree that audit reports should be resolved within six months of their issuance, and will make this clear in the planned revision of OMB Circular A-50, "Audit follow-up and resolution."
2.	Recommendation:	"Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness."
	Comment:	We agree that audit-related debts should be recorded as accounts receivable, and will provide guidance on the proper accounting for audit-related debts in the proposed revision to Circular A-50.
3.	Recommendation:	"Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of funding."
	Comment:	We believe audit-related debts should be collected as aggressively as other debts, in accordance with the Claims Collection Standards. We believe all debt collection activity of the Federal Government would be enhanced by passage of debt collection legislation now pending before the Congress and supported by the Administration.

4. Recommendation: "Hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees."

Comment: We believe that grantees are responsible from debts arising from audits of subgrantees; and we agree that, once a determination has been made that a debt exists, the Claims Collection Standards should be applied in collecting it.

5. Recommendation: "Ensure compliance with the Claims Collection Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less."

Comment: We are working with key debt collection officials in the departments and agencies to assure full compliance with the Claims Collection Standards, and to assure the proper settlement of all debts.

6. Recommendation: "Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal."

Comment: We are working with designated audit follow-up officials in all major agencies to assure that unnecessary delays are eliminated from the audit appeals process. To discourage unwarranted appeals, we plan to include a provision in Circular A-50 calling for interest to accrue while appeals are pending.

7. Recommendation: "Require interest to be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition."

Comment: We agree that interest should accrue on audit-related debts as well as on other debts. We believe that all debt collection activity of the Federal Government would be enhanced by passage of debt collection legislation now pending before the Congress and supported by the Administration.

8. Recommendation: "Require grantees to certify that their payment of audit-related debts does not reduce the level of benefits of any Federal program and institute program and audit follow-up."

Comment: We see no need for a certification, but we do plan to include a provision in Circular A-50 requiring that payment of audit-related debts must not result in a reduced level of program activity or in charges to other Federal programs.

Mr. HORTON. As to your comments with regard to the specific recommendations and the disposition as far as OMB is concerned and whether they can be included or whether they are being included in the circular and so forth—that is what I am looking for. If they are not, then explain to us why it is not necessary or why you do not feel it should be done.

Mr. STEINBERG. Fine.

Mr. HORTON. Second, I think it would be helpful if you were to take a look at this report. Staff has informed me that this only went through June of last year. It might be helpful if you could give us some comments for the hearing record with regard to this report, so that it is all placed in the proper context as far as the subcommittee is concerned.

Mr. BROOKS. Without objection, the comments will be made a part of the hearing record at this point.

[The material follows:]

The GAO report, "Federal Agencies Negligent In Collecting Debts Arising From Audits," includes agency data as of June 30, 1981. We believe the situation has improved considerably since then as a result of agencies designating top level audit follow-up officials, by our review and coordination of their follow-up systems, and by the intense management concern generated by making audit follow-up and resolution an Administration priority. The continued oversight activity of this Committee and GAO's involvement have also been positive forces in keeping agency attention focused on debt collection and follow-up. We believe passage of debt collection legislation now pending before the Congress, and supported by the Administration will enhance agency ability to collect audit related debts.

Mr. HORTON. Also, I understand that you have put out questions and answers on Circular A-123, Internal Controls Systems. Would you say a word or two about that?

Mr. STEINBERG. Sure.

Mr. HORTON. I ask, Mr. Chairman, whether we might have that included—not necessarily printed in the record but made a part of it.

Mr. BROOKS. Without objection, the material will be made a part of the record at this point.

[The material follows:]

Questions and Answers

ON

CIRCULAR A-123

"INTERNAL CONTROL SYSTEMS"

FEBRUARY 1982

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

OVERVIEW OF A-123

Q. THE INSPECTORS GENERAL ARE DOING A GOOD JOB IN UNCOVERING CASES OF FRAUD, WASTE, AND ABUSE. WHY DO WE NEED A-123?

A. Yes, the IGs are doing a good job in identifying cases of fraud, waste, and abuse. They also are involved in efforts with agency officials to prevent fraud, waste, and abuse from occurring in the first place. However, we believe that the agencies have not placed enough emphasis on preventive measures. The objective of A-123 is to ensure that internal controls and other preventive measures are in place and working.

Q. O.K. SO I'M STUCK WITH A-123. WHAT ACTIVITIES DOES IT APPLY TO?

A. In a single word: everything! Both programs and administrative functions; i.e., accounting systems and the food stamp program; personnel administration and new drug registrations; procurement and regulation of pesticides.

Q. WHAT EXACTLY IS IT THAT A-123 REQUIRES ME TO DO?

A. Three basic things:

1. To prescribe agency policies and standards for internal control by March 31, 1982.
2. To conduct by December 31, 1982, vulnerability assessments of all agency activities. A plan for conducting the assessments must be prepared by March 31.
3. To conduct, on an ongoing basis, internal control reviews to identify internal controls that need to be strengthened or streamlined, and implement the necessary improvements.

Q. WHY HAS A DEADLINE BEEN SPECIFIED FOR CONDUCTING THE VULNERABILITY ASSESSMENTS BUT NOT THE INTERNAL CONTROL REVIEWS?

A. It must be emphasized that the A-123 requirements are not a one-time effort. Agencies must provide for and carry out vulnerability assessments and internal control reviews on a permanent basis. The December 31 deadline for vulnerability assessments is for the first cycle; vulnerability assessments of agency activities must be conducted at least every two years thereafter.

It is impossible to establish in A-123 deadlines for internal control reviews. The number of internal control reviews under way at any time and their duration depends on a number of factors, such as the number and complexity of agency activities, vulnerability to fraud, and the availability of resources to conduct reviews.

Q. I'M CONFUSED ABOUT THE ROLE OF MY INSPECTOR GENERAL IN ALL THIS. COULD YOU PROVIDE SOME CLARIFYING INFORMATION?

A. The Circular does not set forth any new or revised role for the Inspector General. It reaffirms that IGs may conduct internal control reviews of their own choosing, and that the reviews should include an evaluation of compliance with the Circular. Beyond this, the role of the IG is an individual agency situation. Because of the technical expertise in the IG office, we hope there will be a sharing of ideas and information and to the extent possible, actual participation in the A-123 process.

AGENCY DIRECTIVE AND PLAN

Q. AS I UNDERSTAND IT, A-123 REQUIRES EACH AGENCY TO HAVE IN PLACE BY MARCH 31 AN AGENCY DIRECTIVE SETTING FORTH THE AGENCY'S POLICIES ON INTERNAL CONTROLS?

A. That's correct. The major requirements for the directive are:

1. Designation of an official, establishment of a committee, or other assignment of agency-wide responsibility for the internal control program.

2. Assignment of the responsibility for internal control to specific officials in each component of the agency and provision that performance appraisals reflect accomplishment of this responsibility.

3. Establishment of a system of vulnerability assessments and internal control reviews. As noted previously, there must also be a plan for conducting the first cycle of assessments by December 31.

4. Establishment of administrative procedures to enforce the internal control program.

Q. WHAT LEVEL OF OFFICIAL SHOULD BE ASSIGNED RESPONSIBILITY FOR AN AGENCY'S INTERNAL CONTROL PROGRAM?

A. Obviously it can vary according to individual situations and the agency head's wishes. Typically, however, it would be a top level official with broad management responsibilities. Examples are an Under Secretary, Assistant Secretary for Management, or an Assistant Secretary for Planning and Evaluation. In some cases it might be an Executive Assistant to the Secretary.

Q. WHAT ABOUT THE LEVEL OF THE OFFICIALS IN THE AGENCY COMPONENTS?

A. It would be comparable officials at the Bureau or Administration level. You may also designate lead or responsible officials at lower organizational levels if it makes sense, but it is not required by the Circular.

Q. DOES MY PLAN FOR THE FIRST CYCLE OF VULNERABILITY ASSESSMENTS HAVE TO BE PART OF THE DIRECTIVE?

A. Not necessarily. It could be incorporated in the directive, be an attachment to the directive, or just be referenced in the directive and issued as a separate document. It doesn't even have to be issued at the same time as the directive as long as it's before the March 31 deadline.

Q. WHAT ABOUT THE PLAN FOR VULNERABILITY ASSESSMENTS. WHAT ELEMENTS SHOULD IT INCLUDE?

A. Very simply, the plan is a description of the major events and dates for conducting the vulnerability assessments by December 31, 1982. The plan must include two very key elements:

- a list of agency programs and administrative functions to be subjected to a vulnerability analysis; and
- the approach to be used in conducting the first cycle of vulnerability assessments.

Q THE "APPROACH TO BE USED" FOR THE VULNERABILITY ASSESSMENTS. WHAT DOES THAT MEAN?

A. It means that there's more than one way to skin a cat. The thing to remember--as we'll discuss in more detail later on--is that the vulnerability assessment is just a survey of the potential for fraud, waste, and abuse, not the degree to which existing internal controls actually prevent fraud, waste, and abuse. Also remember that the major goal of the vulnerability assessment is to produce a ranking of the programs and administrative functions' vulnerability to fraud, waste, and abuse so that you know your priorities for internal control reviews. Any reasonable approach to achieving these goals is acceptable.

On the other hand, the description of the approach should be specific. It should identify the persons or groups that will perform the assessments and contain milestone dates with which progress can be measured.

Q. YOU JUST CONFUSED ME. YOU SAID THE PLAN FOR VULNERABILITY ASSESSMENTS DOESN'T HAVE TO INCLUDE AN EVALUATION OF EXISTING CONTROLS. BUT THE CIRCULAR LISTS "ASSUMED EFFECTIVENESS OF EXISTING CONTROLS" AS A CONSIDERATION IN VULNERABILITY ASSESSMENTS.

A. That's correct. The key word is "assumed". You don't have to conduct at this point a review to validate your impressions about how well existing controls are working. That's done as part of the internal control review.

VULNERABILITY ASSESSMENTS

Q. WHAT'S INVOLVED IN MAKING A VULNERABILITY ASSESSMENT FOR A PROGRAM OR ADMINISTRATIVE FUNCTION?

A. Three basic steps:

1. Analyze the general control environment.
2. Analyze the inherent risk.
3. Do a preliminary evaluation of existing safeguards.

Q. I'M NOT FAMILIAR WITH THE PHRASE "GENERAL CONTROL ENVIRONMENT." WHAT DOES IT MEAN?

A. It is a term used to refer to a number of factors which can have a major impact on the effectiveness of internal controls. A complete list and description will be provided in the OMB guidelines for internal control systems now under development, but the factors include:

1. Management attitude toward the development and maintenance of internal controls.
2. An organizational structure which has an appropriate grouping of activities and reporting relationships.
3. The competence and integrity of the organization's personnel.
4. Appropriate delegation and limitation of authority.

Q. SO I LOOK AT THESE AND THE OTHER FACTORS LISTED IN THE GUIDELINES. WHAT DOES IT TELL ME?

A. If an organization receives high marks on these factors, controls are likely to be effective in preventing and detecting fraud, waste, and abuse. In situations where a poor internal control environment exists, there is a much greater likelihood of losses no matter how well designed controls appear to be.

Q. WHAT ABOUT THIS ANALYSIS OF "INHERENT RISK"?

A. Because of their very nature, some activities are more vulnerable than others to fraud, waste, and abuse. The Circular and the OMB guidelines list several aspects to be considered, including:

1. Purpose and characteristics of the activity
2. Budget allocation
3. Impact outside the agency
4. Age and life expectancy
5. Degree of centralization
6. Special concerns

Q. SO IF I EVALUATE EACH OF MY PROGRAMS AND ADMINISTRATIVE FUNCTIONS AGAINST THESE CONSIDERATIONS THEN I WILL HAVE A VULNERABILITY ASSESSMENT AND CAN COME UP WITH RELATIVE RANKINGS?

A. Almost. Don't forget that you also have to consider the results of your review of the general control environment and preliminary assessment of existing safeguards. A program that has high inherent risk but rates very well on general control environment and the effectiveness of existing controls may end up being considered of moderate vulnerability and low in the relative rankings. Conversely, a program with only moderate inherent risk but with a poor control environment and suspect existing controls might end up being your highest vulnerability.

Q. THIS VULNERABILITY ASSESSMENT PROCESS SOUNDS LIKE A LOT OF WORK WHICH WILL EAT UP MY ALREADY SCARCE RESOURCES?

A. It can be--but it doesn't have to be! First, try to avoid doing the vulnerability assessments at too detailed a level. Secondly, remember that the basic purpose of the vulnerability assessment process is to determine when and in what sequence reviews of the effectiveness of internal controls should be performed and systems improved. Any reasonable means to this end is acceptable.

For example, it might be possible in a small agency, or even in a bureau or administration of a department, for the vulnerability assessments to be based on a one day meeting of top officials. The officials could come up with vulnerability assessments and a relative ranking based on their own working knowledge of the programs and administrative functions, and their general impressions about the control environment and the effectiveness of existing controls. If used correctly, this can produce results just as valid as a painstaking examination of each general control environment factor and each inherent risk factor for all programs and administrative functions. The only requirements are that: (1) the process and the major considerations in coming up with the relative rankings are documented; and (2) the agency head will approve (and defend) the rankings.

INTERNAL CONTROL REVIEWS

Q. WHAT IS AN INTERNAL CONTROL REVIEW?

A. An internal control review is a detailed examination of a program or administrative function to determine whether adequate controls against fraud, waste, and abuse exist, and whether they are working.

Q. WHAT'S INVOLVED IN CONDUCTING AN INTERNAL CONTROL REVIEW?

A. The guidelines prepared by OMB describe in detail the steps involved in conducting an internal control review. The material in the guidelines is based on accepted auditing and accounting standards.

In basic terms, an internal control review consists of:

1. The identification and documentation of "transaction cycles" for the program or administrative function. Transaction cycles is a fancy word for describing a series of related events which are repeated on some regular basis. Normally you would expect several transaction cycles for each program or administrative function.
2. Analysis of the general control environment if it was not done during the vulnerability assessment.
3. The identification of needed controls for each transaction cycle, and the comparison with existing controls to determine missing (or unnecessary) controls.
4. The testing of existing controls to see if they are working.
5. Reporting the results of the review by identifying the weaknesses within the system and recommending how they can be corrected.

Q. HOW IS THE TESTING OF EXISTING CONTROLS ACCOMPLISHED?

A. By selecting a sufficient sample of transactions and then reviewing documentation, asking questions, and personally observing to determine if the controls are functioning as intended.

Q. THE RECOMMENDATIONS FOR CORRECTIONS--ON WHAT ARE THEY BASED?

A. The recommendations for corrections should correlate with risk; that is, whenever you see in the transaction cycle a potential for fraud, waste, or abuse, then there should be a control imposed. Remember, however, that the level of control should be selected to provide a reasonable, but not absolute, assurance against loss. Internal controls must be cost-effective.

Q. WOULD THE FINAL EVALUATION EVER INCLUDE ANYTHING EXCEPT A DISCUSSION OF SPECIFIC CONTROLS?

A. Certainly. We have discussed how important the general control environment is to the effective use of internal controls. When the internal control review identifies weaknesses in personnel, organizational structure, etc., then these should also be addressed in the report.

Mr. STEINBERG. The President's concern with fraud, waste, and abuse is not a narrow concern. He wants us to face and attack it from all directions. Improving the internal control systems is one of the major areas which he wants us to use. We have decided to use that to fight fraud, waste, and abuse.

OMB issued a circular in October requiring the agencies to evaluate and improve their systems of internal control. This is not an easy subject. It is rather complex.

Mr. HORTON. Is that Circular A-123?

Mr. STEINBERG. Yes.

Mr. HORTON. Perhaps, Mr. Chairman, we ought to put that in the record as well.

Mr. BROOKS. Without objection, so ordered.

[The material follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 28, 1981 CIRCULAR No. A-123

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Internal Control Systems

1. Purpose. This Circular prescribes policies and standards to be followed by executive departments and agencies in establishing and maintaining internal controls in their program and administrative activities.

2. Background. The Budget and Accounting Procedures Act of 1950 requires the head of each department and agency to establish and maintain adequate systems of internal control. The Antideficiency Act, 31 U.S.C. 665, requires that agency systems for the control of funds be approved by the Director of OMB. Despite these statutory requirements, there continue to be numerous instances of fraud, waste, and abuse of Government resources and of mismanagement of Government programs. These problems frequently result from weaknesses in internal controls or from breakdowns in compliance with internal controls.

3. Policy. Agencies shall maintain effective systems of accounting and administrative control. All levels of management shall involve themselves in assuring the adequacy of controls. New programs shall be designed so as to incorporate effective systems of internal control. All systems shall be evaluated on an ongoing basis.

4. Definitions. For the purpose of this Circular, the following terms are defined:

   a. Agency -- any department or independent establishment of the executive branch.

   b. Agency Component -- a major organization, program, or functional subdivision of an agency having one or more separate systems of internal control.

   c. Internal Controls -- the plan of organization and all of the methods and measures adopted within an agency to safeguard its resources, assure the accuracy and reliability of its information, assure adherence to applicable laws, regulations and policies, and promote operational economy and efficiency.

d. Internal Control Documentation -- written policies, organization charts, procedural write-ups, manuals, memoranda, flow charts, decision tables, completed questionnaires, software, and related written materials used to describe the internal control methods and measures, to communicate responsibilities and authorities for operating such methods and measures, and to serve as a reference for persons reviewing the internal controls and their functioning.

e. Internal Control System -- the totality of the methods and measures of internal control for all or part of an agency.

f. Vulnerability Assessment -- a review of the susceptibility of an agency or program to loss or unauthorized use of resources, errors in reports and information, illegal or unethical acts, and/or adverse or unfavorable public opinion.

g. Internal Control Review -- a detailed examination of an agency's or agency component's system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner.

5. Responsibility. Designing, installing and monitoring internal control systems for their effectiveness and identifying and initiating needed changes is the responsibility of the agency head. The Inspector General, or his equivalent in agencies without an Inspector General, also has a responsibility in regard to internal controls, as explained in paragraph 5b.

a. Agency heads are responsible for the establishment and maintenance of a system or systems of internal control within their agencies. This responsibility includes determining that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

Each agency head shall issue an internal control directive (if one does not exist) and a review plan by March 31, 1982 (see paragraph 8). Where additional internal control directives are required for agency components, the head of the agency shall ensure that such directives are consistent with the agency directive.

b. The Inspector General, or the senior audit official where there is no Inspector General, will, in conjunction with internal audits, review internal control documentation, systems, and compliance to determine whether the policies and standards established by this Circular are being implemented properly. Reviews should also be made of the audit follow-up system in order to ensure management's follow-up of audit findings and recommendations. Additional reviews will be performed as necessary to provide sufficient agency coverage.

6. Objectives of Internal Control. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that financial and other resources are safeguarded from unauthorized use or disposition; transactions are executed in accordance with authorizations; financial and statistical records and reports are reliable; applicable laws, regulations and policies are adhered to; and resources are efficiently and effectively managed.

7. Standards of Internal Control. Certain basic standards shall be adhered to in the system(s) of internal control established by an agency or agency component. These include: documentation, recording of transactions, execution of transactions, separation of duties, adequate supervision, access to resources, competent personnel, and reasonable assurance.

a. Documentation -- Internal controls, accountability for resources, and all financial transactions shall be clearly documented, and documentation shall readily be available.

b. Recording of Transactions -- Transactions shall be recorded as executed, when executed, and be properly classified.

c. Execution of Transactions -- Independent evidence shall be maintained that authorizations are issued by persons acting within the scope of their authority and that transactions conform with the terms of the authorizations.

d. Separation of Duties -- Key duties such as authorizing, approving, recording transactions, issuing or receiving assets, making payments, and reviewing or auditing shall be assigned to separate individuals to minimize the risk of loss to the Government. Internal control depends largely on the elimination of opportunities to conceal errors or irregularities. This in turn depends on the assignment of work in such a fashion that no one individual controls all phases of an activity or transaction, thereby creating a situation that permits error or irregularities to go undetected.

e. Supervision -- Qualified and continuous supervision shall be provided to assure that approved procedures are followed. Lines of personal responsibility and accountability shall be clear.

f. Access to Resources -- Access to resources shall be limited to authorized personnel. Access includes both direct physical access and indirect access through the preparation or processing of documents that authorize the use or disposition of resources. Periodic comparison shall be made of the resources with the recorded accountability to determine whether the two agree. The frequency of the comparison shall be a function of the vulnerability of the asset.

g. Competent Personnel -- Reasonable care shall be taken that key personnel have high standards of integrity, and are competent, by education, training or experience to accomplish their assigned duties.

h. Reasonable Assurance -- Internal control systems shall provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This standard recognizes that the cost of internal controls should not exceed the benefits derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives.

8. Requirements for Agency Internal Control Directive and Plans. An agency directive and accompanying plan required by paragraph 5 will, at a minimum:

a. Identify an appropriate official, establish an internal control committee, or otherwise establish specific responsibility for seeing that agency internal control systems are developed (where they do not exist), maintained, reviewed, and improved as necessary.

b. Provide for coordination between program managers and technical staffs, including the Office of Inspector General or its equivalent in agencies without an Inspector General, in matters concerning internal control.

c. Assign responsibility for internal control to specific officials in each component of the agency and provide that performance appraisals reflect accomplishments of this responsibility.

d. Require each internal control system to meet the standards of internal control described in paragraph 7.

e. Provide a plan by March 31, 1982 for vulnerability assessments covering all agency components to be accomplished by December 31, 1982, and as frequently as circumstances warrant thereafter, but not less frequently than biennially. Such assessments should be used to determine when and in what sequence reviews of the effectiveness of internal controls should be performed and systems improved or documented.

Vulnerability assessments should consider, but need not be limited to, the following: newness of the program, dollar value of the program, nature of the program and its clientele, recent changes in program control or resource levels, impact of the program on persons or organizations external to the agency, the appreciation for effective internal control by persons operating the program, assumed effectiveness of existing controls, recent instances of errors or irregularities, and the interval since the most recent evaluation or audit.

f. Provide for internal control reviews on an ongoing basis to determine whether the controls are operating as intended and are effective. These reviews should identify internal controls that need to be strengthened or streamlined. They should be a part of normal management and budget analyses and should draw on available audit reports and other sources.

The frequency of the reviews shall be determined by the Inspector General and/or the agency head. The Inspector General may do a review at any time.

g. Establish administrative procedures to enforce the intended functioning of the internal controls. Included in the procedures should be notations in performance appraisals for positive accomplishments related to internal controls, appropriate disciplinary actions for violations of internal controls, and correction of internal control weaknesses, however identified.

These procedures should also include reports to the agency head on all significant internal control breakdowns and financial losses, in accordance with criteria established by the agency head. Reporting and discipline for lesser violations may be handled at lower levels.

9. Specific Internal Control Guides. Models and other guidelines for internal controls for specialized aspects of agency operations will be developed from time-to-time and issued separately to aid agencies in designing specific internal control systems.

10. Reporting. Agencies may be required to include information on financial losses, system breakdowns and progress in making system reviews as part of their annual report to OMB on financial management improvement.

11. Effective Date. This Circular is effective on publication.

12. Inquiries. All questions or inquiries should be addressed to the Financial Management Branch, Office of Management and Budget, telephone number 202/395-4773.

13. Sunset Review Date. This Circular shall have an independent policy review to ascertain its effectiveness three years from the date of issuance.

David A. Stockman

David A. Stockman
Director

Mr. **Brooks**. We will take a look at it and see how long it is before deciding whether or not to include it as part of the record.

Mr. **Steinberg**. It is not too long. We try to be concise.

Mr. **Brooks**. You are handling the Paperwork Reduction Act, so you need to be aware of that too.

Mr. **Steinberg**. That is right.

We are taking a number of routes to try and implement that circular. We have met with the Assistant Secretaries for Management, whom we believe are the main people to implement Circular A-123. We briefed them on what is required. There is another meeting tomorrow as a followup on that because of the complexity of the subject.

We have briefed the Inspectors General at a special council meeting. We issued questions and answers because the subject is so complex, and we wanted to explain it in everyday language, if you will.

We have a set of guidelines which is going out today in draft form to a whole host of people to get their reactions. That, basically, will help them to adopt the provisions of A-123.

We are working with individual agencies——

Mr. **Horton**. I think it would be helpful if we had a copy of that for the record as well.

Mr. **Steinberg**. All right.

Mr. **Brooks**. Without objection, it will be made a part of the record at this point.

[The material follows:]

DRAFT

February 24, 1982

GUIDELINES FOR THE EVALUATION AND IMPROVEMENT OF INTERNAL CONTROL SYSTEMS IN THE FEDERAL GOVERNMENT

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

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FOREWORD

There is an increasing awareness that strong systems of internal accounting and administrative control can help to prevent fraud, waste, abuse and mismanagement in Federal Government operations. This document provides a general discussion of suggested procedures that may be used to evaluate and improve internal control throughout the Federal Government.

This document focuses on the performance of vulnerability assessments and internal control reviews, by providing a discussion of procedures that can be used in the assessment and review process. Related background information, sample forms, and various attachments containing relevant detailed information are also included. The intent is to provide general guidelines for agencies to use in designing their own specific plans for evaluating and improving their internal control systems in the most economic and efficient manner.

We are grateful to the interagency working group that developed the information contained herein and to those government officials and others who have provided comments.

Signature

Date

CHAPTER 1

INTRODUCTION

Internal Control is defined as the plan of organization and all of the methods and measures used within a Federal agency to safeguard its resources, assure the accuracy and reliability of its information, assure adherence to applicable laws, regulations and policies, and promote operational economy and efficiency. An internal control system is the totality of the organization, methods and measures.

An internal control system is not a separate system in an agency. It is an integral part of the programs and functions performed by the agency and the systems used to operate these programs and functions. Thus, internal control is the responsibility of the same individuals responsible for operating the programs and functions.

Furthermore, internal control systems are necessary not only for financial and administrative activities. They are equally necessary for program activities, such as determining eligibility for an entitlement program or conducting a research program. Indeed, a strong system of internal control can be a useful tool for the prevention of the types of fraud, waste and abuse that are endemic to Federal government programs.

In addition to the management and economic value of internal control, there are certain legal requirements that must be considered. These are the Budget and Accounting Procedures Act of 1950, which requires the head of each Federal department and agency to establish and maintain adequate systems of internal control, and OMB Circular No. A-123, "Internal Control Systems," which sets standards for internal controls and directs each agency to review and update its internal control system on an ongoing basis. Also, legislation has been introduced in Congress that requires the head of each agency to report to the President annually on his or her agency's internal control.

The purpose of this publication, therefore, is to provide guidance for the reviews and updates of the internal control system.

THE BASIC APPROACH TO REVIEWING AND UPDATING INTERNAL CONTROLS

A review and evaluation of internal control can be approached in several ways. The approach presented in this publication, however, provides an efficient and effective way, based on techniques used by financial auditors to review and evaluate the internal controls associated with financial statements, but expanded to encompass the controls necessary for administrative and program activities.

The recommended approach is comprised of three phases:

- Organizing the process into manageable tasks by first segmenting the agency into organizational components, and then identifying the programs and administrative functions conducted in each component. The most meaningful evaluations of internal control are performed at this level. For example, the Department of Health and Human Services can be segmented into the Social Security Administration, the Health Care Financing Administration, etc. The Social Security Administration, in turn, would then be segmented into the Supplemental Security Income program, the Old-Age Survivors Insurance program, a Cash Disbursing function, etc.

- Assessing the vulnerability to fraud, waste, and abuse of each program and administrative function within each component and deciding which are the most vulnerable. This is done by identifying the factors that create an inherent riskiness in the function, considering the operating environment in which the function is performed, and preliminarily evaluating whether safeguards exist to prevent fraud, waste, or abuse from occurring.

- Reviewing the internal controls in the functions deemed most vulnerable by determining whether adequate control measures exist, and whether they are functioning as intended. This step also would entail developing recommendations to correct weaknesses in either the design or functioning of the internal control system.

The internal control review and evaluation process is depicted in a flow chart (Exhibit 1) and explained in detail in Chapters II to IV. The remainder of this Chapter discusses some preliminary considerations, such as organizing and staffing reviews and evaluations in order to obtain the appropriate level of quality for the effort and documenting the results.

OVERVIEW OF THE INTERNAL CONTROL REVIEW AND EVALUATION PROCESS

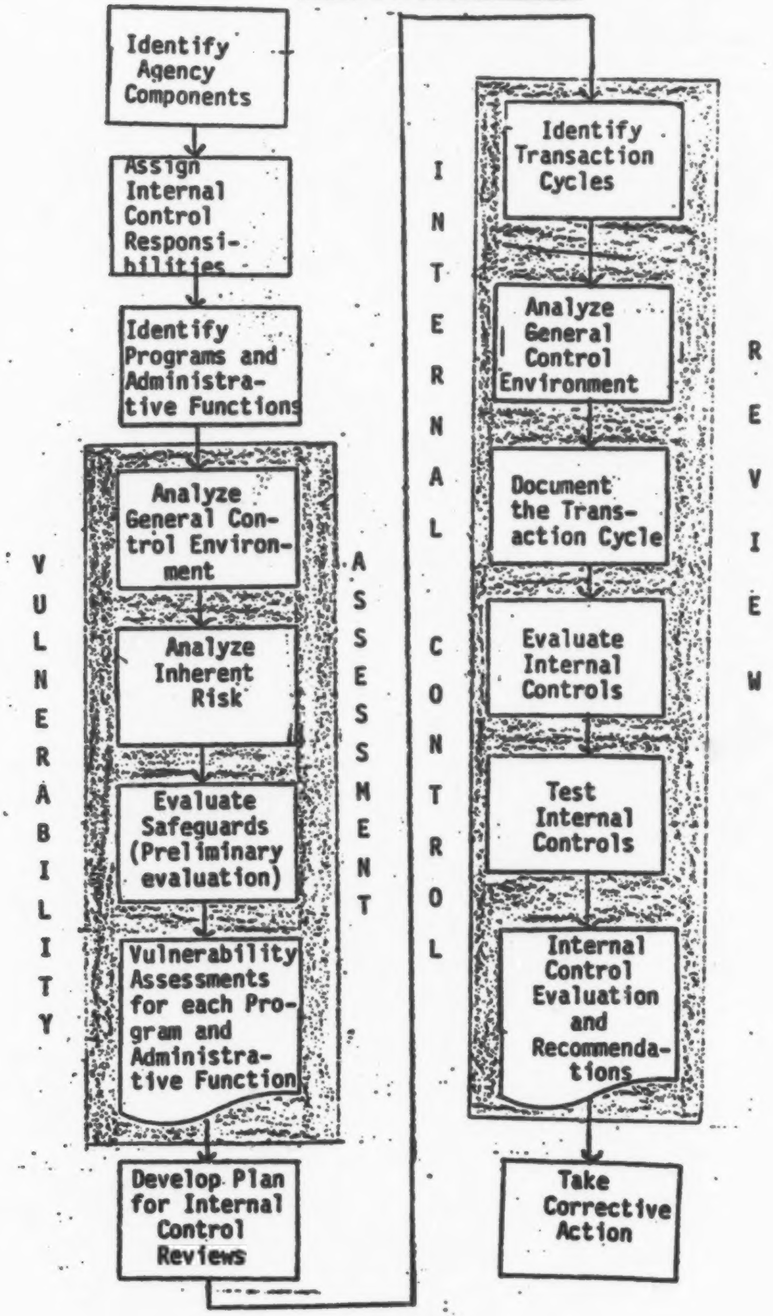

Identify Agency Components
Assign Internal Control Responsibilities
Identify Programs and Administrative Functions
Analyze General Control Environment
Analyze Inherent Risk
Evaluate Safeguards (Preliminary evaluation)
Vulnerability Assessments for each Program and Administrative Function
Develop Plan for Internal Control Reviews
VULNERABILITY
ASSESSMENT
INTERNAL CONTROL
Identify Transaction Cycles
Analyze General Control Environment
Document the Transaction Cycle
Evaluate Internal Controls
Test Internal Controls
Internal Control Evaluation and Recommendations
Take Corrective Action
REVIEW

Exhibit 1

SOME PRELIMINARY CONSIDERATIONS

Federal Departments and agencies are large organizations - in expenditures, scope of operations and number of locations. It is thus critical that the review and evaluation of internal control be organized and staffed in a manner that will assure complete coverage of the department/agency in a systematic, efficient and effective manner.

Assignment of Responsibilities

The first preliminary step is the designation of responsibility for the reviews and evaluations. This is different than the responsibility for developing and maintaining the internal controls. As stated, developing and maintaining internal controls is the responsibility of the persons managing and operating the programs and administrative functions.

Circular A-123 states that the responsibility for the reviews and evaluations can be placed with an individual or a committee. In view of the sizes of the agencies, it also directs that there be an assignment of responsibility in each component of the agency. In both instances - at the agency-wide level and within the components - this assignment should encompass the reviews and evaluations of internal controls in both programs and administrative functions.

Staffing

The reviews and evaluations can be performed by persons from many parts of the agency. Examples are the individuals who operate the system being reviewed, persons from the Administrative Assistant Secretary's Office, or persons from the Office of Inspector General. What is important is that the individuals have sufficient understanding to make the judgments required for these processes.

Some specific measures that should be considered to assure the necessary quality are as follows:

- Orientation and training - Conduct orientation and/or training sessions to explain the objectives of and procedures for conducting vulnerability assessments and internal control reviews.

- Assignment of personnel - Consider using the "team" approach, whereby small groups of individuals perform assessments and/or reviews jointly. This provides some assurance that the limitations of one individual can be offset by the strengths of another. It also stimulates the individual team members' thinking.

- Supervision - Provide for adequate supervision of personnel involved in the assessment and review processes.

- Performance appraisal - Develop a mechanism to evaluate performance related to assessment and review activities and advise personnel that this will be a consideration in their overall performance evaluation.

- Technical assistance - Develop and provide employees with a procedures manual, including standard forms as appropriate, to be used in the performance of vulnerability assessments and internal control reviews. Designate and provide personnel with a list of agency "experts" who can answer questions and provide other assistance in this area.

- Monitoring - Develop a monitoring system to assure that assessments and reviews are adequately performed. One such system could be a management oversight committee that tests assessments and reviews as deemed necessary.

Documentation

Written documentation should be maintained for all activities conducted in connection with vulnerability assessments, internal control reviews and follow-up actions to provide a permanent record of the work performed and to support conclusions. This information will also be useful for performing subsequent assessments and reviews, evaluating the performance of individuals involved in these activities, and reviewing the validity of conclusions reached.

CHAPTER II

IDENTIFYING PROGRAMS AND ADMINISTRATIVE FUNCTIONS

The first phase in the recommended approach is to segment the agency into components and to then identify the programs and administrative functions in each component. This phase is necessary because: (1) it is at the program and administrative function level that internal controls operate and must be evaluated; (2) it is the only way the review and evaluation function can be made manageable; and (3) it is the way to be certain all programs and administrative functions are properly identified and systematically assessed. Also, it facilitates the allocation of resources to the assessment process.

SELECTING THE COMPONENTS, PROGRAMS AND FUNCTIONS

There is no set way to divide an agency into components for purposes of reviewing and evaluating internal control, particularly since agencies vary so widely in terms of organizational structure and the nature of activities conducted. However, a recommended approach is to first consider the existing organizational structure, the nature of the programs and administrative functions, and the size of each; to then classify the agency into its organizational components; and to finally divide the organizational components into programs and functions.

This process should not be performed in the abstract or in general terms. Indeed, reference should be made to such sources of information as the budget and related materials, organization charts, agency manuals, and program and financial management information systems. The following specific factors should be considered:

- numbers of sub-programs or sub-functions in a program or function
- number of separate organizations operating the program
- degree of independence for the program or function
- differences in operating systems
- degree of centralization or decentralization
- budget amounts
- numbers of personnel

The degrees of independence and centralization/decentralization are very significant. A program or administrative function could operate in several locations. Since the internal control system may vary among locations -- possibly in design and certainly in operation -- it is usually necessary to perform separate vulnerability assessments and internal control reviews for each location. Thus a consideration when classifying programs and functions operating at several locations is whether to first identify the locations and then list the programs and functions operating within each location, or to first identify the programs and functions, and then for each multi-location program and function, identify and list the locations at which it operates. Either way is acceptable, as long as coverage is complete.

Appendix A shows a sample of a partial classification of components, programs and administrative functions for a Cabinet level department.

Scheduling the Vulnerability Assessments

Once the agency components and programs and administrative functions are identified and classified, the information should be documented. (A suggested format for such documentation is provided in Exhibit 2). These lists provide the means for scheduling the vulnerability assessment.

Circular A-123 requires that vulnerability assessments covering all agency components be accomplished by December 31, 1982 and at least biennially thereafter. To fulfill this goal, the individual or committee responsible for the reviews and evaluations should use the lists of programs and administrative functions for each component and schedule the assessments in accordance with some meaningful criteria, e.g., size, location, available personnel. Obviously the agency individual or committee can have the responsible official in each component perform the scheduling for his or her component, and then combine those schedules into an overall agency-wide schedule. Also, the scheduling should specify the person or group who will perform the assessment and the date by which it should be completed.

As will be seen in the next chapter, vulnerability assessments should be neither extensive nor time-consuming. They can therefore be assigned to individuals who operate the program or function, assuming the individuals have the necessary qualifications and understanding and are properly supervised. Another way is to have senior officials in each component meet for a day and develop the vulnerability assessments and a relative ranking based on their knowledge of the programs and administrative functions. In short, they should not take long to complete.

Agency Component - ____________________

List of Programs and Administrative Functions Within the Component

Programs/Administrative Functions	Comments

Prepared by ______________ Date ________

Reviewed by ______________ Date ________

EXHIBIT 2

CHAPTER III

VULNERABILITY ASSESSMENTS

A vulnerability assessment is a review of the susceptibility of a program or function to unauthorized use of resources, errors in reports and information, illegal or unethical acts, and/or adverse or unfavorable public opinion. It is based on considerations of the environment in which the program or function is carried out and the inherent riskiness of the program or function, and a preliminary evaluation as to whether adequate safeguards exist and are functioning.

It must be emphasized, however, that the internal control evaluation and improvement process does not stop with vulnerability assessments, since by themselves vulnerability assessments do not identify weaknesses or result in improvements. Rather, they are the mechanism with which an agency can quickly determine the relative potentials for loss in its different programs and functions, and then schedule internal control reviews and other steps accordingly.

The three basic steps in the vulnerability assessment process are discussed in the next three sections.

ANALYSIS OF GENERAL CONTROL ENVIRONMENT

The environment in which activities are conducted has a major impact on the effectiveness of internal controls over the agency. Several factors determine the general control environment, including the following which are drawn from the General Accounting Office document, Executive Reporting on Internal Controls in Government:

- Organizational Structure -- the identification of organizational units to perform the necessary functions and the establishment of appropriate reporting relationships;

- Personnel -- the competence and integrity of the organization's personnel;

- Delegation and Communication of Authority and Responsibility -- appropriate delegation or limitation of authority in a manner that provides assurance that responsibilities are effectively discharged;

- Budgeting and Reporting Practices -- specification and communication of organizational goals and the extent of their accomplishment through appropriate levels of budgeting and reporting;

- Organizational Checks and Balances -- the establishment of an appropriate level of financial control and internal auditing; and

- ADP Consideration -- when utilized, an awareness of the strengths and exposures inherent in such an installation and the implementation of controls to give recognition to their existence.

An evaluation of the overall general control environment is the first step in the vulnerability assessment process. It would be performed by determining whether the characteristics of a strong general control environment, as described above, are in existence by (a) reviewing documented policies and procedures; (b) conversing with management and other personnel; (c) observing practices; and (d) drawing upon a familiarity with the operation.

The evaluation may be performed for the component as a whole or individually for each program and administrative function carried out within the component. The determining factors would be the size and nature of the programs and functions conducted within the agency component.

Exhibit 3 presents a form which may be useful in making the analysis.

ANALYSES OF INHERENT RISK

The next step in the vulnerability assessment process is the performance of an analysis for each identified program and administrative function, of the inherent potential for fraud, waste, or abuse due to the nature of the activity itself. Matters to be considered should include, but need not be limited to, the following for each program:

- Purpose and characteristics
- Budget allocation
- Impact outside the agency
- Age and life expectancy
- Degree of centralization
- Special concerns
- Prior reviews
- Management responsiveness

Purpose and Characteristics

The purpose and characteristics of the program or administrative function should be considered, and any aspects that make the activity susceptible to fraud, waste, or abuse noted. Knowledge of the purpose and characteristics can be obtained, if not already available, by reviewing

Agency Component - ____________________

Analysis of General Control Environment

Program/Administrative Function -- ______________________________

Factor	Evaluation		Comments
	Satisfactory	Other	
Management Attitude			
Organizational Structure			
Personnel			
Delegation and Communication of Authority and Responsibility			
Budgeting and Reporting			
Organizational Checks and Balances			
ADP Considerations			
Other Factors			

Overall Evaluation:

Prepared by ______________ Date ________

Reviewed by ______________ Date ________

EXHIBIT 3

such background material as the enabling legislation and legislative history, regulations, statements of missions, goals and objectives, operating procedures and policies, and budget materials. The following purpose and characteristics should be noted, since on balance they tend to contribute to fraud, waste and abuse.

- Broad or vague legislative authority or regulations.
- Cumbersome legislative or regulatory requirements.
- Broad or vague missions, goals or objectives.
- High degree of complexity.
- Existence of third party beneficiaries.
- Activities involving the payment of entitlement monies.
- Activities operating under severe time constraints.
- Activities involving the handling of cash receipts.
- Activities involving approval of applications, granting of authority, certifications, issuance of licenses or permits, inspections, or enforcement.

Budget Allocation

Programs or activities expending large amounts of money are susceptible to greater amounts of fraud, waste, or abuse than programs or activities expending small amounts. Accordingly, the level of funding, including personnel time allocated to the program or function, should be determined by reviewing the agency budget and supporting materials. For certain activities the budget may not reveal the total money allocated, so estimates should be made and/or other financial measures considered. For example, for a function such as property management, there is not a separate budget. In order to measure the full financial significance of this function, the value of controlled property must be determined.

Impact Outside the Agency

Government programs and functions often have considerable financial and non-financial impact on persons and organizations external to the agency. For example, activities such as the issuance of registrations or permits, standard-setting, rate-making, and licensing can affect significantly economic status, health, safety, national security, etc. When a program has such impacts, it is going to be susceptible to external pressures, which might circumvent internal controls. Hence, impact outside the agency should be considered.

Information concerning potential impact can usually be obtained from such sources as budget documents, program descriptions, and media and public interest reports.

Age and Life Expectancy

Consideration should be given to the age and life expectancy of the program or administrative function. New (in existence less than two years), changing (undergoing substantial modification or reorganization), or phasing out (to be eliminated within 1 or 2 years) programs should be considered more susceptible to fraud, waste, abuse or mismanagement than stable programs (in existence for more than two years and not expected to phase out within two years). The reasons are as follows:

- New or changing programs may lack written policies or procedures, lack adequate resources, have inexperienced managers, lack devices to measure program performance, and in general have considerable confusion associated with them.

- Phasing out programs may lack adequate resources or may involve close-out activities for which controls have not been developed and/or large amounts of money or other resources which must be accounted for. Also, personnel often lose interest and motivation when a program is phasing out.

Degree of Centralization

The extent to which the program or administrative function is conducted in a centralized or decentralized mode should be considered. Specifically, a determination should be made as to whether the activity is:

- Federal Centralized -- Managed and controlled on a day-to-day basis in a centralized Federal agency system.

- Federal Decentralized -- Managed and controlled on a day-to-day basis by Federal agency field installations or staffs.

- Participant Administered -- Managed and controlled on a day-to-day basis by a private organization. Programs supported by grants, contracts or loans would fall into this category.

- Other -- Managed and controlled on a day-to-day basis by some combination of the above or by other means.

In most instances, the greater the degree to which the activity is decentralized, the more susceptible it will be to fraud, waste and abuse.

Special Concerns

Often, the existence of special interests for an activity may be indicative that for some reason it is highly susceptible to fraud, waste, or abuse, or at least should be treated as such. Consideration should therefore be given as to whether the program or administrative function has been the focus of the following types of special attention:

- Special interest exhibited by the President, Congress, OMB or the Secretary.

- Deadlines set by legislation.

- Media attention.

- Litigation.

- Business, social or economic phenomena.

If special attention has been focused on the program or function, special problems related to its exposure to fraud, waste, or abuse may exist.

Prior Reviews

Prior Inspector General reports, General Accounting Office audits, internal evaluations, and IPA or state audits should be reviewed for any indications that the program or administrative function has previously been subject to losses due to fraud, waste, or abuse. The amounts of estimated losses, if any, and the period covered by the prior review should be considered.

Programs or functions with minimal audit coverage or with significant and repeated findings should be considered more susceptible to fraud, waste, or abuse.

Management Responsiveness

Management's responsiveness to recommendations from its OIG, GAO, and other evaluation groups should be considered. This would include actions taken to correct problems brought to management's attention as a result of prior reviews. A lack of responsiveness suggests a higher degree of susceptibility to fraud, waste, or abuse.

* * *

The list of control objectives contained in Appendix B may be useful in identifying certain risks that must be considered for each of the programs and functions being assessed.

PRELIMINARY EVALUATION OF SAFEGUARDS

The third step in the vulnerability asessment process is the making of a preliminary judgment regarding the existence and adequacy of internal controls over the specific programs and administrative functions. The key consideration should be whether appropriate controls are in place to prevent or at least minimize potential losses from fraud, waste, or abuse.

As stated, an in-depth review of the existing controls is not appropriate at this stage. Rather, the evaluator's judgment should be based largely on his or her perceptions of the existence and functioning of safeguards that protect the activity's resources from fraud, waste, or abuse. However, the evaluation must be thoughtful and based on a working knowledge of the program or administrative function. Judgments made without knowledge of the situation are usually not sufficiently reliable.

APPLYING THE RESULTS OF THE VULNERABILITY ASSESSMENTS

The completion of the three steps permits the assessor to make an overall assessment of the vulnerability of the program or administrative function. The assessment should be documented (see Exhibit 4 for a suggested form) and a conclusion reached as to overall vulnerability, e.g., highly vulnerable, requiring a detailed review of internal controls; moderately vulnerable, permitting less intensive and less frequent internal control reviews; absence of vulnerability, etc.

Agency Component - ____________________

Overall Vulnerability Assessment

Program/Administrative Function -- ________________________________

OVERALL EVALUATION OF GENERAL CONTROL ENVIRONMENT: ____________________

ANALYSIS OF INHERENT RISK

Factor	Rating	Comments
Purpose and Characteristics		
Budget Allocation		
Impact Outside the Agency		
Age and Life Expectancy		
Degree of Centralization		
Special Concerns		
Prior Reviews		
Management Responsiveness		
Other Factors		

OVERALL EVALUATION OF INHERENT RISK: ________________________________

PRELIMINARY EVALUATION OF SAFEGUARDS: ____________________________

OVERALL VULNERABILITY: ________________________________

SPECIAL ATTENTION REQUIRED: ________________________________

Internal Control Review Scheduled For ______________

To be Performed By: ____________________________

Prepared by ______________ Date ____________

Reviewed by ______________ Date ____________

EXHIBIT 4

Completed vulnerability assessment documents should be transmitted to an maintained by the individual or committee responsible for overseeing the reviews and evaluations of internal controls. Part of that person or persons' job is the specification of the need for and timing of internal control reviews based on the degree of vulnerability for the programs an functions assessed and the resources available to conduct the reviews. The information regarding the scheduling should be maintained as part of the documentation.

Problems or weaknesses requiring immediate corrective action may be note during the performance of the vulnerability assessments. For instance, program may be assessed in which the controls are perceived to be grossl inadequate and there is a strong possibility of loss if corrective actio is not taken immediately. Such situations should be brought to the attention of the appropriate agency official as soon as possible in orde that appropriate corrective actions can be taken.

CHAPTER IV

INTERNAL CONTROL REVIEWS

As stated, internal control reviews are the detailed examinations of an internal control system undertaken to determine whether adequate controls exist and are functioning as intended. They are performed in each program and administrative function, based on the results of the vulnerability assessments.

There are six steps to an internal control review. They are:

- Identification of the transaction cycles encompassed in the program or administrative function.
- Analyses of the general control environment.
- Documentation of the transaction cycle.
- Evaluation of the internal controls within the transaction cycles.
- Testing of the internal controls.
- Reporting the results.

This Chapter describes how to perform these six steps.

IDENTIFICATION OF THE TRANSACTION CYCLES

Transaction cycles are the processes used to initiate and perform related activities, create the necessary documentation, and gather and report related data. Each program and administrative function carried out within an agency or agency component contains one or more transaction cycles. For examples, an entitlement program could contain the following transaction cycles: outreach, information gathering and verification, eligibility determination, information processing and record keeping, payment, and monitoring. The transaction cycles for an administrative function could be payroll, employee benefit programs and allowances, procurement of supplies and materials, etc. (Appendix B presents the transaction cycles commonly found in Federal Government agencies).

Transaction cycles provide the focal points for the conduct of internal control reviews. Accordingly, the first step in the internal control review phase is to list the transaction cycles in the program and administrative functions subject to review. The sources of information for developing such a list would be Appendix B, the vulnerability assessment for the program/function, legislation, regulations, policy statements, procedures manuals, management interviews, etc. Exhibit 5 provides a form on which the cycles can be listed.

Agency Component -

List of Transaction Cycles Within Programs and Administrative Functions

Program/Administrative Function -

Transaction Cycles	Comments

Prepared by   Date

Reviewed by   Date

EXHIBIT 5

ANALYSIS OF GENERAL CONTROL ENVIRONMENT

The environment in which the cycle operates has a major impact on the effectiveness of the internal controls. Therefore, an important part of an internal control review is an evaluation of the general control environment, i.e., the management attitude, organization structure, personnel, delegation and communication of authority and responsibility, budgeting and reporting practices, organizational checks and balances.

Analysis of the general control environment performed for the vulnerability assessment can be referred to and updated, if available. If it is not available, a new analysis of the general control environment, using the same procedures suggested for the vulnerability analysis, should be performed.

DOCUMENTATION OF THE TRANSACTION CYCLE

The next step is to document the transaction cycles in order to obtain a thorough understanding of how they operate. This is accomplished by interviewing the personnel involved in the cycle and observing the activity, and then preparing either a narrative explanation or a flow chart. The documentation should contain sufficient detail to permit the in-depth analysis of the existence and adequacy of internal controls, as discussed in the next section.

Flow charts, particularly if accompanied by pertinent narrative information describing the documents and processes contained therein, facilitate analysis. Accordingly, Appendix C provides some basic instructions on how to flow chart. Exhibit 6 shows a flow chart for a typical payroll cycle.

Regardless of the documentation vehicle, it is advisable to review the completed documentation with the persons providing the information, and to track one or two transactions through the process. Both techniques will assure that the documentation and the understanding of the cycle are accurate.

EVALUATION OF THE INTERNAL CONTROLS WITHIN THE TRANSACTION CYCLES

The fourth step in the process is to evaluate the documentation for each transaction cycle and decide whether the system, at least as defined, is sufficient to safeguard the agency's resources, assure the accuracy and reliability of its information, assure adherence to applicable laws, regulations and policies, and promote operational economy and efficiency. The manner in which this is done is to:

- Define the control objectives for each transaction cycle. Control objectives are expressions of the manner in which the basic standards of internal control (documentation, recording of transactions, execution of transactions, separation of duties, supervision, access to resources, competent personnel, reasonable assurance -- See OMB Circular No. A-123) would be applied to a specific transaction cycle in order to enable the overall internal control objectives for that cycle to be met.

- Examine the documentation and decide whether there are sufficient documents and processes to enable the control objectives to be met.

  The relationship between this and the prior task and the inherent risks in a transaction cycle cannot be emphasized sufficiently. Control objectives are established because a risk exists; the documents and processes can stop the specific risk from occurring. For example, there is often the risk in a payroll system of people not working the time for which they are paid. Thus an appropriate control objective would be "payments are made only in return for services." A document and process that could be considered sufficient are time sheets requiring supervisor approval.

- Identify whether there are any controls that are excessive, thereby creating inefficiencies and ineconomies.

The results of this process are an identification of (a) necessary internal controls whose functioning has to be tested, as discussed in the next section; (b) objectives for which there are no controls and thus systems corrections must be made; and (c) unnecessary controls that can be eliminated.

A form that may be useful in documenting this information is presented in Exhibit 7.

Appendix B provides the control objectives for the common transaction cycles.

TESTING OF THE INTERNAL CONTROLS

The final step in an internal control review is the testing of the identified necessary controls to determine whether such controls are functioning as intended. The best way to do this is to select a sample of transactions and to then review the documentation for those transactions, as well as make other observations and inquiries and ascertain whether the specified steps were performed. Statistical sampling may be useful for enhancing the effectiveness of this process.

Agency Component - ____________________

List of Internal Controls

Program/Administrative Function - ______________________________

Transaction Cycle ____

Control Objectives	Control Features	Strength (S) Weakness (W) Excessive (E)	Comments

Prepared by _____________ Date ________

Reviewed by _____________ Date ________

EXHIBIT 7

Sometimes a specified control will appear to be inadequate for a given condition or not functioning. In those instances, the reviewer should evaluate whether personnel are compensating for the shortcoming with other safeguards of which the reviewer is not aware, or whether compensating controls exist in interrelated systems not subject to review.

The reviewer should complete the testing step by noting any necessary controls not functioning as intended or compensated for. He should also consider how such shortcomings could be corrected. A form for such notations is presented in Exhibit 8.

REPORTING THE RESULTS

The results of each internal control review should be reported to the manager of the program or administrative function and to the individual or group in the agency component responsible for internal control reviews. The report should contain an identification of weaknesses within the system and recommendations as to how they can be corrected. Recommendations for possible improvements in the economy and efficiency of the internal controls should also be made, if appropriate.

More specifically, attention should be given to the following:

- In what ways is the general control environment inadequate to provide the necessary atmosphere for the appropriate functioning of specific controls?

- In what areas are controls nonexistent or inadequate?

Agency Component - ____________________

Tests of Internal Controls

Program/Administrative Function - ______________Transaction Cycle _____

Necessary Controls	Functioning (Yes or No)	Adequate (Yes or No)	Comments and Recommendations

Prepared by _____________ Date ________

Reviewed by _____________ Date ________

EXHIBIT 8

- In what areas are controls not functioning as intended?

- In what areas are controls excessive, thereby fostering a lack of economy or creating inefficiencies?

- In what ways are executive, legislative, or other management requirements excessive, thereby creating inefficiencies?

As stated, the report should include recommendations for how such situations could be corrected or improved. In evaluating possible alternatives, consideration should be given to the costs and expected benefits of changes in order that control objectives can be achieved in a cost effective manner. While it is sometimes difficult to determine the exact costs of and benefits to be derived from suggested improvements, it is necessary to at least make an estimate of these amounts so that controls are not put into place that cost more than they save.

FOLLOW-UP ACTIONS

Vulnerability assessments and internal control reviews and reports should not be an end in themselves. The recommended corrective actions should be taken on a timely basis. Indeed, it is probably appropriate to establish and maintain a formal follow-up system that logs in and tracks recommendations, provides assistance for the development of plans for implementation of the corrections, and monitors that the changes are made as scheduled.

GLOSSARY

Agency -- Any department of independent establishment of the executive branch.

Agency Component -- A major organization, program, or functional subdivision of an agency having one or more separate systems of internal control.

Control Objective -- A statement of application of a basic internal control standard to a specific transaction cycle that identifies how a particular risk can be safeguarded against.

General Control Environment -- Various environmental factors that can impact the effectiveness of internal controls over program and administrative functions.

Inherent Risk -- The potential for loss from fraud, waste, or abuse due to the inherent nature of an activity.

Internal Control -- The plan of organization and all of the methods and measures adopted within an agency to safeguard its resources, assure the accuracy and reliability of its information, assure adherence to applicable laws, regulations and policies, and promote operational economy and efficiency.

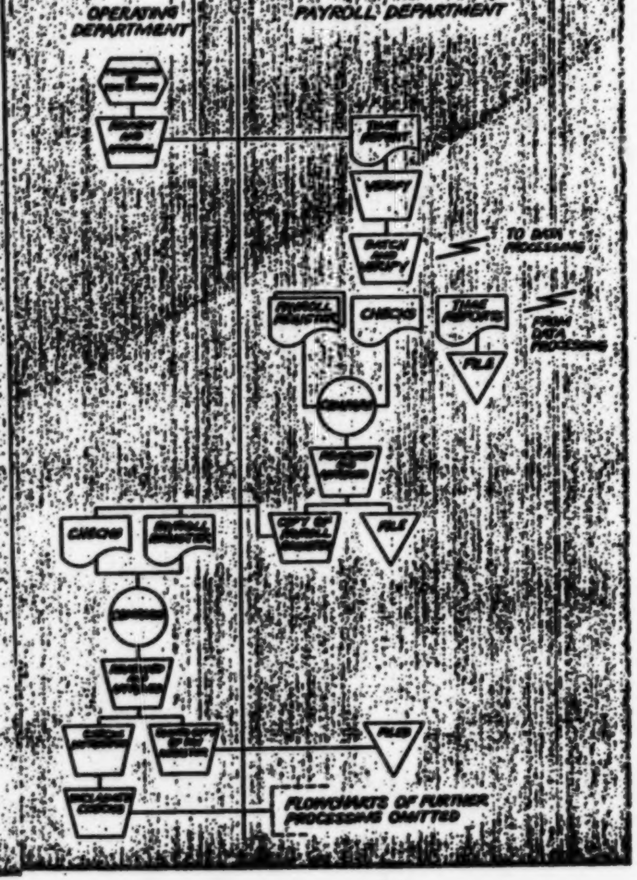
Internal Control Review -- A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner.

EPT. PROOF AUG 30 1982

EXHIBIT 6

PAYROLL TRANSACTION CYCLE

PROCEDURE	PERSONNEL
1. EMPLOYEE PREPARES TIME REPORT	EMPLOYEE
2. TIME REPORT REVIEWED, APPROVED AND SIGNED BY SUPERVISOR AND SUBMITTED TO PAYROLL DEPARTMENT	SUPERVISOR
3. PAYROLL DEPARTMENT CHECKS FOR SUPERVISOR APPROVAL, AND PROPER COMPLETION OF TIME REPORT. TIME REPORTS ARE ENTERED BY PAYROLL CLERK	PAYROLL CLERK 1
4. PAYROLL DEPARTMENT BATCHES DOCUMENTS, PREPARES AND VERIFIES BATCH CONTROL AND TRANSMITS TO DATA PROCESSING	PAYROLL CLERK 2
5. DATA PROCESSING SUBMITS TO PAYROLL DEPARTMENT A PAYROLL REGISTER (TWO COPIES), EMPLOYEE CHECKS, AND THE TIME REPORTS	DATA-PROCESSING
6. TIME REPORTS ARE FILED	CLERK 1
7. PAYROLL REGISTER AND CHECKS ARE COMPARED	PAYROLL CLERK 2
8. PAYROLL REGISTER AND CHECKS ARE REVIEWED AND APPROVED	SUPERVISOR
9. THE APPLICABLE PORTION OF ONE COPY OF THE PAYROLL REGISTER AND THE CHECKS ARE TRANSMITTED TO THE OPERATING DEPARTMENT. ORIGINAL COPY OF PAYROLL REGISTER IS FILED IN THE PAYROLL DEPARTMENT	CLERK 1
10. PAYROLL REGISTER AND CHECKS ARE COMPARED	CLERK A
11. DEPARTMENT PAYROLL REGISTER AND CHECKS ARE REVIEWED AND APPROVED BY DEPARTMENT HEAD. DEPARTMENT HEAD SIGNS PAYROLL REGISTER.	DEPARTMENT HEAD
12. CHECKS ARE DISTRIBUTED BY CLERK. SIGNED COPY OF PAYROLL REGISTER IS RETURNED TO PAYROLL DEPARTMENT	CLERK A
13. UNCLAIMED CHECKS ARE RETURNED TO PAYROLL DEPARTMENT	CLERK A


OPERATING DEPARTMENT
PAYROLL DEPARTMENT
TIME REPORT
VERIFY
BATCH AND VERIFY
TO DATA PROCESSING
PAYROLL REGISTER
CHECKS
TIME REPORTS
FROM DATA PROCESSING
FILE
COMPARE
COPY OF PAYROLL REGISTER
FILE
CHECKS
PAYROLL REGISTER
FILE
FLOWCHARTS OF FURTHER PROCESSING OMITTED

Internal Control System -- The totality of the methods and measures of internal control for all or part of an agency.

Necessary Internal Control -- A control feature that is being relied on to safeguard an activity from potential losses due to fraud, waste, or abuse.

Transaction Cycle -- The processes used to initiate and perform related activities, create the necessary documentation, and gather and report related data.

Vulnerability Assessment -- A review of the susceptibility of an agency or program to loss or unauthorized use of resources, errors in reports and information, illegal or unethical acts, and/or adverse or unfavorable public opinion.

APPENDIX A

SAMPLE PARTIAL CLASSIFICATION OF COMPONENTS, PROGRAMS, AND ADMINISTRATIVE FUNCTIONS

This appendix illustrates an approach that a department/agency might use to classify its components and programs and administrative functions for purposes of conducting vulnerability assessments. The example is based on operations of the Department of Commerce.

Component (1)	Program and Administrative Function (2)
Patent and Trademark Office	Patent process Trademark process Information dissemination Administration
National Bureau of Standards	Measurement, research, and standards Engineering measurements and standards Computer sciences and technology Central technical support Administration
National Technical Information Service	S
Bureau of the Census	S
Office of Administration	Program planning and personnel Information and resource management Operations/general services Controller's office activities
Office of the Inspector General	Audit Investigative Policy and planning
Office of General Counsel	S
Office of Public Affairs	S
Office of Congressional Relations	S

---

(1) This is a partial listing. Other bureaus would also be included as individual components.

(2) Programs and administrative functions have only been included for a few components. In actual use programs and administrative functions for the other components would also be listed.

COMMON TRANSACTION CYCLES AND CONTROL OBJECTIVES IN FEDERAL AGENCIES

This appendix presents the transaction cycles commonly found in Federal agencies and agency components. Also included are certain types of assets that are highly susceptible to loss and for which controls are vital, e.g., cash, materials and supplies. Finally, the list provides suggested control objectives for each transaction cycle/type of asset.

The purpose of the list is to help agencies and agency components identify the transaction cycles and types of assets and control objectives that need to be considered when performing internal control reviews. The list is classified according to the six major types of cycles/types of assets.

The list is not all-inclusive. Agencies will probably operate transaction cycles not included on the list. Also, internal control objectives not listed may be appropriate. Accordingly, each agency should use this list as a guide and select transaction cycles and internal control objectives for its programs and administrative functions based on a careful analysis.

Also available as a reference source when selecting internal control objectives are the internal control models under development by OMB for several administrative and a few program functions. These models suggest documents, processes and control features that should be reflected in specific systems.

At the present time, internal control models are available for the following programs and administrative functions:

- Periodicals, pamphlets, and audiovisual products.
- Consulting and related services.
- Long-term training.
- Procurement of furniture and equipment.
- Space acquisition.
- Overseas allowances.
- Entitlement programs.

I. OPERATIONS CYCLES

The operations cycles are intended to encompass the agency's program activities. The differences in agency missions make it virtually impossible to develop a representative list of operations cycles and corresponding control objectives. Hence, each agency/agency component should examine its own programs and define the appropriate transaction cycles and control objectives.

The following are the operations cycles for some typical government programs and the internal control objectives for the cycles.

Grants

The primary internal control objectives normally associated with grants include the following:

(1) Adequate public knowledge of nature and availability of Federal assistance.

(2) Accurate maintenance of the factors used in distribution formulas for entitlement grants.

(3) Grantees' program eligibility requirements are sufficiently detailed to ensure that the program beneficiaries are qualified to receive prescribed benefits.

(4) Grantees maintain sound organizational, budgetary and accounting systems that are periodically reviewed and evaluated.

(5) Grantees' procurement procedures comply with regulations.

(6) Grantees properly maintain, safeguard, and account for government-financed property and equipment.

(7) Grantees maintain current cost allocation plans and overhead rates.

(8) Financial and compliance audits of grantee activity performed at least once every two years.

(9) Prompt and appropriate grant close-out actions are taken.

Loans and Loan Guaranties

The primary internal control objectives normally associated with loans and loan guaranties include the following:

(1) Applications for loans and loan guaranties are evaluated for appropriateness of eligibility, collteral, and other qualifying criteria prior to approval.

(2) Title to property used as collateral is properly recorded, filed, and secured by a responsible custodian.

(3) Ability to determine and report age of receivables.

(4) Loan and loan guaranty repayments are collected, controlled and reported in a manner tht is consistent with applicable appropriations and other public laws.

(5) Periodic estimates are made of uncollectible loan balances with such estimates timely reported to management.

(6) Proper write-off, conversion, and settlement or forgiveness of delinquent loans is assured.

II. INTERNAL MANAGEMENT AND ADMINISTRATION CYCLES

Organization

The primary internal control objective normally associated with organization include the following:

(1) Responsibility for the performance of all duties is specifically assigned and appropriately segregated along with necessary delegations of authority to sufficient numbers of qualified employees.

Policies and Procedures

The primary internal control objectives normally associated with policies and procedures include the following:

(1) Policies and procedures are clearly stated.

(2) Policies and procedures are in conformance with applicable laws and regulations.

(3) Policies and procedures are systematically communicated throughout all levels of the organization.

Internal Reviews of Operations and Resource Utilization

The primary internal control objectives normally associated with internal reviews of operations and resource utilization include the following:

(1) Review staff and other resources are used in an optimum manner.

(2) Reviews are timely performed.

(3) Reviews consider all pertinent points needed to identify the best mode of operation or departures from prescribed policies, procedures, and criteria.

(4) Recommended actions are implemented completely, timely and appropriately and continue to be used effectively.

Budget Development

The primary internal control objectives normally associated with budget development include the following:

(1) Budget goals and objectives clearly defined and widely understood.

(2) Process for gathering and reviewing relevant input clearly and widely understood.

(3) Budget accurately reflects the planned use of resources.

(4) Budget is concise and easily understood.

(5) Budget can be effectively used to measure progress or lack of progress in achieving stated goals.

Personnel Policies and Practices

The primary internal control objectives normally associated with personnel policies and practices include the following:

(1) Recruitment, training, evaluation, and termination practices are operating in accordance with applicable laws and regulations and in a manner that promotes economy and efficiency of operations.

(2) Appropriate standards of conduct are communicated and enforced.

(3) Employment records are promptly, completely and accurately estalished with proper safeguards against unauthorized access or the preparation of ficticious records.

Administrative Services

The primary internal control objectives normally associated with administrative services include the following:

(1) Services provided meet the organization's legitimate needs.

(2) Services are conducted in a manner that promotes economy and efficiency in operations.

(3) Safeguards exist to prevent unauthorized or wasteful use of such services.

Advisory and Technical Services

The primary internal control objectives normally associated with advisory and technical services include the following:

(1) Services provided meet the organization's legitimate needs.

(2) Services are conducted in a manner that promote economy and efficiency in operations.

(3) Safeguards exist to prevent unauthorized or wasteful use of such services.

Security and Safeguarding of Classified Material

The primary internal control objectives normally associated with security and safeguarding classified material are the following:

(1) Documents are appropriately classified.

(2) Appropriate safeguards exist to prevent unauthorized access to classified materials.

III. INFORMATION PROCESSING AND REPORTING CYCLES

Information Collection

The primary internal control objectives normally associated with information collection are the following:

(1) Information collected is meaningful and useful.

(2) Information collected is reliable.

(3) Information is arranged in an orderly fashion.

(4) Information is maintained on a current basis.

Correspondence Handling

The primary internal control objectives normally associated with correspondence handling are the following:

(1) Correspondence is channeled to the appropriate parties.

(2) Replies are made promptly, accurately and responsively.

Records Maintenance

The primary internal control objectives normally associated with records maintenance are the following:

(1) Records are readily available.

(2) Records are adequately protected.

(3) Only necessary records are retained.

Automatic Data Processing

The primary internal control objectives normally associated with automatic data processing are as follows:

(1) Proper authorization of transaction inputs, adequate edit checks, and necessary safeguards of sensitive input forms to insure accurate, proper, complete and timely entry of information.

(2) Data is safeguarded to prevent unauthorized access, improper changes, or loss.

(3) Appropriate controls exist to detect unauthorized use of the system.

(4) Outputs produced accurately, completely and timely.

IV. ASSET AND LIABILITY CYCLES

Cash

The primary internal control objectives normally associated with cash include the following:

(1) Physical security safeguards maintained where cash is stored and processed.

(2) Cash, check signing machines, signature dies, and blank, partially prepared mutilated, and voided checks are protected from unauthorized use.

(3) Receipts are properly and timely recorded and deposited promptly.

(4) Disbursements are properly and timely recorded.

(5) Effective cash management system is maintained.

Negotiable Instruments and Other Investments

The primary internal control objectives normally associated with negotiable instruments and other investments include the following:

(1) Physical security safeguards are maintained where negotiable instruments and other investments are stored and processed.

(2) Bonds, drafts, and other securities are protected from unauthorized use.

(3) Timely and accurate accounting is maintained.

(4) Investments comply with legal requirements.

(5) Interest and other investment income is collected promptly when due.

Letter of Credit

The primary internal control objectives normally associated with letters of credit include the following:

(1) Letters of credit are issued only to large dollar recipients who have a continuing relationship with the Federal Government and an adequate cash management system.

(2) Amounts available under letters of credit do not exceed available award authority or cash flow needs.

(3) Assurance exists that funds are used for intended purpose.

Receivables

The primary internal control objectives normally associated with receivables include the following:

(1) Prompt and accurate recording of all receivables.

(2) Ability to determine and report sources and age of receivables.

(3) Continuous and timely attempts are made to collect receivables due.

(4) Identification of the portion of the receivables that may not be collectible.

(5) Validity of write-offs, conversions, and settlement or forgiveness of receivables.

(6) Repayments collected, controlled and reported in a manner consistent with applicable law and regulations.

(7) Title to property used as collateral properly recorded, filed, and secured.

Capital Assets and Material Inventories

The primary internal control objectives normally associated with capital assets and material inventories include the following:

(1) Only authorized and needed property is procured.

(2) Receipts of property are timely and accurately recorded in source documents and accounting records.

(3) Detailed subsidiary records are maintained for individual capital assets and significant categories of material inventories and are periodically reconciled to control accounts.

(4) Periodic physical verification is made of the existence and condition of property and inventories.

(5) Physical security measures are commensurate with the size, type, and value of property.

(6) Issues, transfers, retirements, and losses are timely reported and accounted for.

(7) Assets used exclusively for government activities.

Payables, Debt, and Other Liabilities

The primary internal control objectives normally associated with payables, debt, and other liabilities include the following:

(1) All payables and other claims against the Government are promptly and accurately recorded and charged to the proper year's budget.

(2) Prepayment examinations and certifications of performance are made to ensure validity and clerical accuracy of claims prior to payment.

(3) Debt and other long-term liabilities are properly authorized, recorded and serviced in accordance with applicable laws and regulations.

Fiduciary and Trust Funds

The primary internal control objectives normally associated with fiduciary and trust funds include the following:

(1) Liabilities to others are properly recorded.

(2) Detailed subsidiary records are maintained and are periodically reconciled to control accounts.

(3) Funds are handled in accordance with applicable law and regulations.

(4) Effective control is maintained by responsible officials.

(5) Benefits and other disbursements are subject to comparable controls to other payments.

V. RECEIPTS CYCLES

Taxes and Duties

The primary internal control objectives normally associated with taxes and duties include the following:

(1) Taxing programs are applied to all individuals and organizations subject to taxes.

(2) Tax returns and assessments are reasonably correct.

(3) All receipts are accurately and timely recorded.

(4) Receipts are safeguarded while in the custody of the agency and promptly transferred to the Treasury.

(5) Taxing programs are administered in accordance with applicable laws and regulations.

Services Rendered

The primary internal control objectives normally associated with services rendered include the following:

(1) Revenues are recorded immediately as services are rendered with accounts receivable promptly set up if not paid in full.

(2) Receipts are accurately and timely recorded.

(3) Receipts are safeguarded while in the custody of the agency and promptly transferred to the Treasury.

(4) Services rendered and related charges are conducted in accordance with applicable laws and regulations.

Other Sales

The primary internal control objectives normally associated with other sales include the following:

(1) Sales are recorded immediately as items are sold with accounts receivable promptly set up for non-cash sales.

(2) Receipts are accurately and timely recorded.

(3) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.

(4) Sales of goods, property, equipment, bonds, notes, and other items are conducted in accordance with applicable laws and regulations.

Fines, Penalties, and Judgments

The primary internal control objectives normally associated with fines, penalties, and judgments include the following:

(1) Fines, penalties, and judgments are levied on or sought from individuals and organizations as required by laws or regulations.

(2) Fines and penalties are charged at the proper statutory rate.

(3) All receipts are accurately and timely recorded.

(4) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.

Other Receivable Collections

The primary internal control objectives normally associated with other receivable collections include the following:

(1) All receipts are accurately and timely recorded.

(2) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.

(3) Procedures for effecting collection, including offset and installment payments, are utilized on a timely basis.

Other Receipts

The primary internal control objectives normally associated with other receipts include the following:

(1) All receipts are accurately and timely recorded.

(2) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.

(3) Monies are requested and received in situtions where warranted in accordance with applicable law and regulations.

VI. DISBURSEMENT CYCLES

Payroll, Pensions and Other Fringe Benefits

The primary internal control objectives normally associated with payroll, pensions and other fringe benefits include the following:

(1) Appropriate authority exists for the appointment, change, and termination of all personnel.

(2) Compensation and benefit payments are in accord with current statutory or regulatory limitations.

(3) Payments are made only in return for services rendered.

(4) Gross and net payroll amounts and payroll deductions are correct.

(5) Payroll charges, including fringe benefits, are properly recorded and distributed.

(6) Timely, accurate and complete subsidiary records are maintained of employees' pension, vacation, sick leave and other balances.

(7) Payments to trust funds and providers of employee benefits are made promptly and in full.

Federal Assistance Payments to Other Governmental Units and Individuals

The primary internal control objectives normally associated with Federal assistance payments to other governmental units and individuals include the following:

(1) Disbursements are valid and properly approved.

(2) Disbursements are promptly and accurately recorded to the appropriate accounts.

(3) Payments are within budget limits and in accordance with applicable laws, regulations, and agreements.

(4) Payments are made only to eligible recipients for eligible costs.

The primary internal control objectives normally associated with travel advances and reimbursements include the following:

Procurement and Acquisition

The primary internal control objectives normally associated with procurement and acquisition include the following:

(1) All purchases are authorized within budget limits and made in accordance with applicable laws, regulations, and agreements.

(2) Government has paid lowest prices commensurate with quality, service, delivery and reliability.

(3) Purchases and acquisitions are received and examined for acceptability.

(4) Disbursements are valid and properly approved.

(5) Disbursements are made promptly.

(6) Disbursements are promptly and accurately recorded to the appropriate account.

Travel Advances and Reimbursements

The primary internal control objectives normally associated with travel advances and reimbursements include the following:

(1) Travel reimbursements and advances provided only for properly authorized travel .

(2) Amounts paid are in accordance with applicable government travel regulations.

(3) Reimbursements are made promptly, are properly approved, and properly recorded to the appropriate account.

(4) Advances are liquidated within reasonable time periods.

Other Disbursements

The primary internal control objectives normally associated with other disbursements include the following:

(1) Disbursements are valid and properly approved.

(2) Disbursements are promptly and accurately recorded in the appropriate accounts.

(3) Debt service requirements, refunds, valid claims and other appropriate payments are made promptly and in full accordance with applicable laws, regulations, and agreements.

APPENDIX C

BASIC FLOWCHARTING PROCEDURES

A flowchart accompanied by a supplemental narrative is usually the best way to document a transaction cycle. It provides a visual overview of both the cycle and its composite events. Thus, it helps the reviewer gain an overall understanding of the operation of an entire system, perform a thoughtful evaluation of the control strengths and weaknesses in the cycle, and design tests to determine if the internal control system is functioning as intended.

This appendix has been included to present a suggested approach for the preparation of flow charts (see Exhibit 6 for an example).

Sources of Information

Information necessary to prepare a flowchart can be obtained by performing the following steps:

- Review existing systems documentation and internal audit reports.
- Interview appropriate personnel involved in the activity being flowcharted.
- Review forms generated or processed by the information system.

The flowchart should be kept simple. Excessive information, that can make the flowchart confusing, should be avoided. The flowchart should, however, contain sufficient detail to permit identification and evaluation of the internal control strengths and weaknesses.

Basic Instructions

- Flowchart working paper should be obtained and divided into vertical columns, one for each of the following:
  - -- Narrative description of the procedures being flowcharted.
  - -- Designation of job titles for personnel performing each operation.
  - -- A separate column for each department or section involved.

- Procedures should be flowcharted on the chart and described in the narrative using the sequence in which they actually occur. They should be depicted on the flowchart by showing the flow of documents and events vertically from top to bottom and, to the extent practicable, from left to right.

- The narrative included in the procedure column should be used to expand upon or explain the graphic information depicted on the flowchart. With this technique, it is possible to keep the flowchart uncluttered since explanatory comments will be included in the procedure column.

- Brevity and clarity can normally be achieved in the narrative by beginning each sentence with a verb (e.g., "review," "approve," "agree"). Examples of explanatory comments which might appear in the procedure column would include the volume of transactions processed or a listing of items being entered or checked on a form.

- Generally the person performing each operation should be identified by job title rather than by name. This technique provides the reviewer with a more explicit indication of the level and type of personnel responsible for performing each operation. It also helps the reviewer identify possible areas of inconsistent duties (and resultant internal control weaknesses) among personnel. The designation of job title may also be helpful in minimizing revisions when in subsequent years there is a change in personnel.

- The flowchart should use standard symbols for depicting both procedures and documentation . Procedure symbols help to clarify the exact point in the flow of documentation at which each operation occurs.

- To the extent practicable, the procedure symbol for each operation, its narrative description, and the designation of the person performing it should be placed on the flowchart working paper opposite one another. Since each column supplements and complements the others, it is important to be able to refer to the related entries.

- Transaction initiation points should be clearly identified.

- Each copy of multiple copy documents should be numbered or otherwise identified.

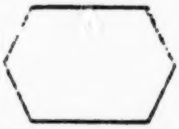
- Each copy of multiple copy documents which enter the system should be indicated (i.e., mailed, filed, transmitted out of the system, etc.).

- The disposition of all documents which enter the system should be indicated (i.e., mailed, filed, transmitted out of the system, etc.).

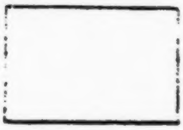
- Sample copies of relevant forms and other documentation should be related to the flowchart.

- As the system is evaluated, existing internal controls should be highlighted directly on the flowchart to facilitate the review. Excessive controls can also be highlighted in this manner.

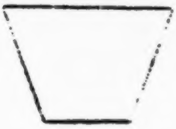
Procedures



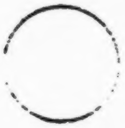
- Prepare/Originate. An operation which involves either preparation of a document or some other form of original work, such as arithmetical calculations.



- Verify/Other Process. An operation which focuses on the checking or verification of work prepared during previous operation, such as the recalculation of arithmetical data.

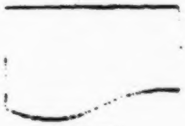


- Review/Approve. An operation in which previously prepared work is reviewed (and usually approved) by a responsible official. The extent of review is typically not so great as in a verification operation, and the person performing this operation is typically someone with supervisory or executive authority.

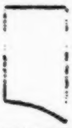


- Compare/Match/Sort. An operation involving more than one document in which the various documents are sequenced, collated, decollated, or compared to one another.

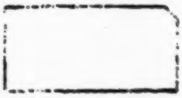
Documentation



- Document. Any document or record other than those specified below.

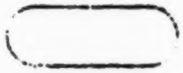


- Tape. An adding-machine or similr tape created by manual methods.

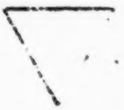


- Punched card. A card with the data in punched-hole form for processing on EDP equipment.

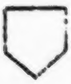
Flow



- Start/Stop. The point, including another department, from which a document enters the system being flowcharted or to which it is transmitted out of the system being flowcharted.



- File. A temporary or permanent storage facility for holding the documents which are processed in the system being flowcharted.



- Connector. An indicator which links two points in the processing flow where the flow has been interrupted by page break or similar occurence.

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Mr. STEINBERG. What I am trying to describe is this. We are not just stopping with the issue of the circular. We feel that just issuing a circular does not necessarily do the job. You need to get in with the agencies and help them through guidelines, see what they are doing, and then help them make adjustments to what they are doing.

Questions and answers is a good way to do it because it explains what we are trying to do in plain English.

Mr. HORTON. I have a number of other questions which I will submit to you and you can supply answers for the record.

Mr. BROOKS. Without objection, they will be made a part of the record.

Mr. HORTON. I do want to ask one other question. A couple of weeks ago, I had my usual office hours in Wayne County and saw about 1,000 people on a 1-to-1 basis. A lot of people were very much concerned about the student loan program and the cutbacks of the program. Many of them came in to see me. I would say that that subject came up more than any other subject.

In connection with the collections of debts, many people were concerned—and I am sure that OMB was concerned—about the fact that some people under those programs could not repay the loans. It has been said to me and I have heard the news media say that no effort is made to collect on them.

Can you tell us what is being done and what the rate of recovery has been with regard to student loans?

Mr. STEINBERG. Yes, sir. The Department of Education is perhaps one of the departments which is making a more active effort in the debt collection area.

With regard to student loans, one of the things they have done, which I think is rather unique, is to go to the outside to use collection agencies. We find that not all of our agencies are permitted to do that. Congress gave them the ability to do that, I believe, a year or two ago.

They conducted a pilot project last year. I believe it was in Oakland and Atlanta. They had excellent results with the pilot project.

They found out that they could take the worst loans, loans which people would not pay to the Education Department employees, and the collection agencies, using professional means—not browbeating or anything but just proper means—were able to get a good collection level. I am not sure what the return on the dollar was. I could find that out for you.

Mr. HORTON. That would be helpful.

Mr. BROOKS. Without objection, that material will be included in the record at this point.

[The material follows:]

According to a report submitted to the Education Department by Booz, Allen, and Hamilton, Inc., the contractor yield is about $2.20 for each dollar of their cost paid by the Federal Government.

Mr. STEINBERG. The effort was so successful that the Department of Education decided to extend it into a much broader effort. Last fall, they put out requests for proposals to debt collection agencies. They received numerous proposals back. Just recently, they selected two debt collection agencies which are going to work in Atlanta, San Francisco, and Chicago to collect the debt.

They will work on the debt which, as I said, the Department cannot collect itself, the debt of last resort.

Mr. **Horton**. I think, in one of the answers you send in, in response to the questions which I will submit to you in writing, you might flesh that out a little bit and give us the information with regard to the law which we passed in setting up the Department of Education. The chairman and I were the principal sponsors of that act and carried the poles on the floor—of the House of Representatives.

You might indicate to us what that law has meant to the Department of Education vis-a-vis other departments and give us some recommendations as to whether or not it would be helpful to the debt collection effort to do that throughout the Federal agencies.

Mr. **Steinberg**. I can say right now that it would be extremely helpful. We think that it is about $360 million of the $500 million for which we need the legislation, which would flow from the ability to use outside collection agencies.

[The information referred to follows:]

The debt collection provisions of the Department of Education Act have proved to be extremely valuable. By authorizing the use of outside collection agencies, the Act made it possible to greatly reduce a huge backlog of debt that had built up over many years. We believe that other agencies would benefit similarly from this type of legislative authority.

Mr. **Horton**. Parenthetically, I will say that I am very much concerned about cutting back the loans for students. I think it would be helpful for OMB and the administration to look at that a bit more carefully because I think there is some injustice in the area.

I realize that there have been abuses, but I think we can correct the abuses without throwing the baby out with the bath water. I did want to ask you to give us the information with regard to that.

Thank you very much, Mr. Chairman.

[Submission to additional questions of Mr. Horton follow:]

Additional Questions
from Representative Horton
Audit Follow-up
February 24, 1982

Question: What is the normal agency practice for terminating audit-related debts?

A. Are debts still terminated or are they negotiated downward on the basis of recent compliance with regulations?

B. What management tools do you have for ensuring that agencies do not take action to terminate debts?

C. If agencies have authority to terminate debts up to $20,000 and only GAO and Justice have authority to terminate debts beyond $20,000, can a debt be negotiated downward below $20,000 and then be terminated?

D. If that can happen, what can be done to prevent it?

Answer: A. Agency practices with regard to terminating or negotiating audit-related debts vary from program to program. In some cases collection action is terminated when it is determined that collection cannot be made, or that it is not in the best interest of the Government to do so. An example of this might be where new management has taken over a community based organization and corrected past deficiencies. A decision might be made in these circumstances to abandon a collection action, if it would result in bankruptcy of the organization or in its inability to carry out needed programs.

B. OMB has been working with the audit follow-up officials to assure that termination policies are clearly spelled out. Inspectors General would be expected to review agency compliance with such policies.

C. Audit-related debts could be negotiated down and then terminated at the lower level, but we have no indication that such a practice is widespread in the agencies.

D. Inspectors General and the General Accounting Office review the appropriateness of termination actions. If they uncover abuses, strong management action should be taken against the responsible officials.

Question: What is OMB's position on charging interest on audit-related debts that are under appeal?

A. Are there any legal restrictions on charging interest on debts under appeal?

B. Why do agencies not charge interest in such cases?

Answer: The Claims and Collection Act of 1966 has been held to provide authority for charging interest on outstanding claims owed the Government, but there has been a general reluctance on the part of agencies to do so, without more specific direction from the Congress.

Last May, the Administration asked Congress for a number of legislative changes needed to strengthen debt collection in the Federal Government, including the charging of interest and penalties on delinquent debts owed the Government. This change will be a clear statement of the intent of Congress that interest and penalties should be charged on debts owed the Government, including those generated from audit disallowances. Senate Bill S. 12491 and House Bill 4614 include this provision.

Question: What is the current status of the revision of Circular A-73?

A. When can we expect the revised circular?

B. What changes can we expect?

C. How will it address audit resolution, including audit-related debt collection?

Answer: A. We expect to make revisions to Circular A-50 and A-73 within the next 60 days.

B. The revised Circulars will combine the procedures for resolving reports of the GAO and Inspectors General. They will specify the role of the Audit Follow-up Officials, define key terms in the audit resolution process, call for prompt action on audit recommendations, provide a maximum of six months for resolution, call for proper recording of audit-related receivables, and require interest to be charged on overdue amounts.

C. Instructions will be provided for the proper recording of accounts receivable when audit-related debts are determined. Procedures for collecting such debts will be addressed as part of our debt collection efforts.

Question: What is OMB's position on recovering funds that have been misspent by subgrantees?

A. Can the grantee continue to receive new grants if subgrantee debts are outstanding? If so, should that policy be reviewed?

B. What guidelines, if any, do agencies give grantees for dealing with subgrantees?

C. Is the money the responsibility of the grantee or the subgrantee?

Answer: A. As we understand it, grantees can continue to receive grants while subgrantee debts are outstanding. We believe this policy should be reviewed, and intend to take the matter up with the audit follow-up officials and the Inspectors General.

B. Guidelines on subgrantee debts vary from program to program, with some agencies providing no guidance at all.

C. We believe the grantee is responsible to the Federal Government. The subgrantee may also be responsible to the grantee, depending on the nature of the contractual agreement between the two.

Question: GAO cites the following example on page 20 of the report: the Food and Nutrition Service in October of last year decided to "drop attempts to collect" a $3.2 million claim.

A. Are you familiar with that decision? If not, would you comment in writing about it?

B. Should that have happened? If so, why? If not, what can be, or is being, done to prevent that from happening again?

Answer: A. We are not familiar with the decision, but will follow up with the Agriculture Department on it. Agriculture will be providing comments to the Congress on the report.

B. Because we are not familiar with the decision, we cannot comment on it at this time.

Mr. BROOKS. Mr. Levitas, the gentleman from Georgia?

Mr. LEVITAS. Thank you, Mr. Chairman.

Have you, Mr. Steinberg, had the opportunity to read the last two committee reports which the committee issued on this subject?

Mr. STEINBERG. I read the most recent one. I probably read the one before that but longer ago than I would care to admit for my memory's purposes.

Mr. LEVITAS. As I am sure you were able to infer from the last report, the one which was issued in the last session of Congress, the committee expressed great concern that the problem of debt collection and audit resolution was still pending and that it had not been dealt with appropriately. At that time, Dr. Harper testified that "the involvement of top management is absolutely vital. Systems alone cannot do the job."

I noticed that, in your testimony, you said that you had provided the committee with a list of persons designated in the various agencies to be the responsible individual dealing with this matter. I have not seen the list.

I would like to get some idea of who some of these people are in some of the agencies and what position or title they hold to make some personal judgment as to whether they are appropriately senior and have responsibilities which would be commensurate with this obligation.

Mr. STEINBERG. I have the list here. They are, basically, the Deputy Secretaries, the Under Secretaries, or the Assistant Secretaries for Administration. In a few instances we have the Assistant to the Secretary.

We share your concern that it had to be a high-level official. Whenever any department came in with someone who was below that ilk, we went right back to them and said they had to be up there.

Mr. LEVITAS. Who is the individual designated at the Department of Defense.

Mr. STEINBERG. At the Department of Defense it is the Assistant to the Secretary of Defense for Review and Oversight.

Mr. LEVITAS. Is that a Presidential appointment?

Mr. STEINBERG. No, sir. It is not.

Mr. LEVITAS. What about the Department of Health and Human Services?

Mr. STEINBERG. It is Dale Sopper, Assistant Secretary for Management and Budget, a Presidential appointment.

Mr. LEVITAS. What about the Environmental Protection Agency?

Mr. STEINBERG. That is John Horton, who is the Associate Administrator for Administration, again a Presidential appointment.

Mr. LEVITAS. What about the Department of Education?

Mr. STEINBERG. At the Department of Education, it is Kent Lloyd, who is Deputy Under Secretary in the administration area.

Mr. LEVITAS. Is that a Presidential appointment?

Mr. STEINBERG. I believe it is.

Mr. LEVITAS. There was one other one, the Department of Labor.

Mr. STEINBERG. At the Department of Labor—I was wondering whether you would ask me one with an Under Secretary—that is Malcolm Lovell.

At HUD we also have an Under Secretary and at Agriculture, a Deputy Secretary.

Mr. LEVITAS. Concerning the Council on Integrity and Efficiency, it recently published a list of some savings resulting from activities which Chairman Brooks covered during his questions to you earlier.

Which agency was reported as having the most success in terms of dollar recovery?

Mr. STEINBERG. The savings are made up of three categories—audit recoveries, cost avoidance, and recoveries from penalties and litigation. I believe the one overall—obviously in each category there would be a leader—was the Department of Defense.

Mr. LEVITAS. When I looked at that list, I was struck by the fact that an agency as relatively small as the Department of Education would have a rather significantly impressive figure. Do you recall what that was and how that was obtained?

Mr. STEINBERG. The Department of Education for audit recoveries had $2,800,000, which is not large in relation to the others. In what we call costs avoided, again it is $2 million, which is not large in relation to the others.

They might have had, in some of the other categories which did not go into the recoveries column—in unresolved questioned costs, they had $68 million. That is fairly large. That did not go into the savings category. Those are the ones which management has not yet agreed should be sustained.

Mr. LEVITAS. I recall that, in earlier hearings we had on this same subject, one of the issues related to the mechanism within each agency for audit resolution. I got the sense that many agencies had different ways and different methods of doing audit resolutions.

Have you focused on the question of the standardization or the appropriateness of the methods used at the separate agencies for audit resolutions?

Mr. STEINBERG. We have, but in a way different than I suspect you might be thinking about. We do not think that they should necessarily be standardized because the agencies are different. Some have field offices. Some do not. Some have grantees. Some do not.

What we have done is to give them a list of attributes of a good followup system. We have told them that their system must conform to those attributes.

We have developed a checklist to see whether or not the system meets the attributes. We review the system with the checklist in view of the attributes. Hopefully, we find the holes in the system that way.

Mr. LEVITAS. What you have established is, first of all, a series of criteria.

Mr. STEINBERG. That is right.

Mr. LEVITAS. Then you have said to the agencies that they should adopt a methodology within their own agencies which conforms to it. You then come back and determine whether the method they have adopted meets your criteria.

Have you done that at each of the agencies?

Mr. STEINBERG. Yes, sir. We have shared the results with each of the agencies. We shared the guidelines with GAO. I believe we gave the results of the evaluations to the General Accounting Office as well.

Mr. LEVITAS. One of the concerns which I have felt as we have gone through this series of hearings, now stretching over several years, is that, inasmuch as this does not seem to be a very exciting undertaking for an agency to do—they would rather give it away than get it back—is that in response to congressional, or sometimes OMB, pressures, they set up mechanisms or paper structures which are responsive to the present authority, and that as the interest diminishes, the paper is still there setting up whatever it is, but the implementation is lacking.

How are you going to deal with that?

Mr. STEINBERG. One of the attributes which we put in the list we gave them and one of the questions in the checklist and one of the things which will be in the circular is the need for the Inspector General to make a periodic review of the followup system itself.

Once we took the Inspector General out of the line of responsibility for followup and let him step back a little bit, it was possible for him to review the system itself. We hope to do it in that way.

Mr. LEVITAS. Clearly, that is going to be one of the questions which I, as one member of this committee, will be looking at down the line.

I have one last question. It is a specific one with regard to recommendation No. 5 in the last report issued by the subcommittee and adopted by the full committee. That is that the Secretary of Defense should "ensure that policy guidance contained in departmental directives on audit resolution and provisions contained in DOD's implementing regulations carry out fully OMB policy guidance on audit resolution and the recommendations of the committee."

Can you inform us what the response has been to that specific recommendation?

Mr. STEINBERG. We have looked at the DOD system as we have looked at the other systems. We are satisfied that the system meets the attributes which we are talking about. Their system is a rather complex system.

I gather that the committee has looked at the system too, and I believe that the chairman has written back to the Deputy Secretary, Mr. Carlucci, complimenting him on the quality of the system.

We are fairly satisfied with it.

Mr. LEVITAS. You are satisfied that the DOD has implemented the recommendation called for in terms of the procedures which comply with OMB guidelines and the committee's recommendations.

Mr. STEINBERG. Basically, our reviews are to make sure that they developed the system and have documented it. That is as far as the reviews go.

We leave the actual implementation, as I said before, to the Inspector General and the General Accounting Office.

Mr. LEVITAS. When you say the Inspector General, do you mean the Inspector General at the Department of Defense?

Mr. STEINBERG. In that instance, it would be the Assistant to the Secretary for Review and Oversight at the present, until such time as the legislation gets passed.

Mr. LEVITAS. Thank you, Mr. Chairman.

Mr. BROOKS. Thank you, Mr. Levitas.

I want to thank you very much, Mr. Steinberg, for coming down.

The hearing has underscored a serious and costly problem.

There is no question about the progress which has been made in improving the audit-resolution process. However, the testimony today of the Comptroller General clearly shows that more can and must be done.

I am encouraged by OMB's assurances that it will work to bring about improvements in this area.

I believe that the Inspectors General, whose offices we worked so hard to create, are doing a good job. However, there are real battles to be won in the war on waste, and I do not believe it helps anyone to engage in make-believe figures on savings. They should be as concise and as well defined as is possible.

The subcommittee will continue to monitor improvements in this area until it is satisfied with the progress being made. We intend to review the steps OMB takes to insure that all stages in the audit-resolution process are made a high priority and that the process adequately insures that collections are made when Federal money is found to have been misspent.

The subcommittee appreciates the fine work of the GAO in this most critical area. Their work has contributed a great deal, both to this hearing and to the effectiveness of auditing in the entire Federal Government. We look forward to their continuing efforts in this area.

The subcommittee is adjourned, subject to the call of the Chair.

[Whereupon, at 11:08 a.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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APPENDIXES

APPENDIX 1.—CHAIRMAN BROOKS' LETTER TO DEPARTMENTS AND AGENCIES OF GOVERNMENT AND RESPONSES

JACK BROOKS, TEX., CHAIRMAN
DANTE B. FASCELL, FLA.
DON FUQUA, FLA.
ELLIOTT H. LEVITAS, GA.
DAVID W. EVANS, IND.
HENRY A. WAXMAN, CALIF.

FRANK HORTON, N.Y.
JOHN N. ERLENBORN, ILL.
M. CALDWELL BUTLER, VA.
WILLIAM F. CLINGER, JR., PA.

225-5147

NINETY-SEVENTH CONGRESS
Congreſs of the United States
House of Representatives
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-373
WASHINGTON, D.C. 20515

February 24, 1982

Honorable John R. Block*
Secretary of Agriculture
Department of Agriculture
Washington, D.C. 20250

Dear Mr. Secretary:

Enclosed for your review and comment is the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits." I am also enclosing specific examples of collection problems GAO found in your agency.

The GAO review was performed at my request as the result of a series of hearings that were held by the Subcommittee on the failure of Federal departments and agencies to follow up and resolve audit findings. Deficiencies in the collection of audit disallowances were brought up repeatedly during the Subcommittee hearings.

The Subcommittee would appreciate your comments regarding the reasons for any deficiencies found by the GAO in your procedures and practices, as well as the actions you are taking to comply with Federal collection regulations and OMB guidelines. In addition, please respond in detail on the current status of each of the enclosed cases. I am also enclosing some questions for your response, to be included as a part of the February 24, 1982 Subcommittee hearing record on Federal Departments' and Agencies' Failure to Collect Audit-Related Debts.

I hope that we can receive your comments by March 30, 1982. Your cooperation and immediate attention in reviewing and commenting on this material would be sincerely appreciated. I look forward to your responses.

With best wishes, I am

Sincerely yours,

JACK BROOKS
Chairman

Enclosures

*An identical letter with separate examples was also sent to the heads of the Departments of Education, Health and Human Services, Housing and Urban Development, Labor, Transportation, and the Environmental Protection Agency.

CASE EXAMPLES SUBMITTED TO THE DEPARTMENT OF AGRICULTURE

CASE NUMBER USDA-1

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

Audit Report Number and Date: 2714-59-SF issued 12/26/71

Auditee: Food Stamp Program, Santa Clara County Department of Social Services,
San Jose, California

Amount Questioned: $713,272

Amount Disallowed: $ 52,768

Date of Disallowance: Unknown - see case facts

Recovery Action Taken: Offset against State's letter of credit 08/10/81.

Appeal Status: No appeal filed.

CASE FACTS:

12/26/71 - Audit report released. The auditors reported cash and coupon shortages of $713,272.

02/18/72 - The USDA Regional Office agreed with the auditors' findings.

04/09/80 - National Office sent the State agency the third billing letter. Previous billing letters could not be located.

04/14/81 - FNS adjusted the amount of the disallowance to $52,768 subsequent to this date.

08/10/81 - FNS offset the claim of $52,768 against the State's letter of credit.

09/15/81 - Audit closed.

PRESENT STATUS:

Closed, disallowance recovered.

GAO ASSESSMENT:

Agriculture never established formal accounting control over this debt. FNS collection methods allowed the debt to "slide" — remaining open for almost 10 years. FNS officials could not locate the first two billing letters; therefore we were unable to determine the date a disallowance was established. No interest was charged or collected on this debt.

CASE NUMBER USDA-2

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

Audit Report Number and Date: 60235-2 issued 04/16/74

Auditee: Child Nutrition Programs, Los Angeles Unified School District
Los Angeles, California

Amount Questioned: $1.3 million

Amount Disallowed: $1.3 million

Date of Disallowance: 06/19/75

Recovery Action Taken: $154,185 recovered on 07/29/80

Appeal Status: No appeal filed.

CASE FACTS:

04/16/74 - Audit report released. The auditors found that the school district was over-reimbursed $1.3 million because it had provided free or reduced price meals without regard to the actual eligibility of the students.

06/27/75 - The Regional Office reported that a school district official could not justify the eligibility of the questioned meals and decided to pay the overclaim.

06/07/79 - The Regional Office requested the National Office to concur with a proposed letter to the State agency. The Regional Office wanted to request the State agency to clarify prior correspondence within 60 days or threaten offset to their Letter of Credit.

01/10/80 - The National Office threatened the school district with fiscal action to recover the overclaim as reported by the audit if the auditee did not reply.

01/31/80 - The State agency informed the school district that if a response was not received by 02/15/80, the claim would be offset.

03/13/80 - The State agency told the Regional Office that the school district had a counterclaim which would reduce the claim to approximately $150,000.

03/20/80 - The Regional Office billed the State agency.

04/28/80 - The Regional Office told the State agency to bill the school district for $154,185 and consider the remainder of the claim unresolved.

05/16/80 - The State agency billed the school district for $154,185.

06/23/80 - The National Office indicated that the $1.3 million should be collected.

07/29/80 - The State agency acknowledged receipt of $154,185. (A school district official told us that payment was made from the cafeteria fund which contains Federal, State, and local funds.)

08/04/80 - The State agency informed the Regional Office of the recovery and the claim was referred to the Claims Control Branch within the National Office.

08/18/80 - The Claims Control Branch requested USDA General Counsel concurrence in reducing the claim.

PRESENT STATUS:

Open, partially recovered as of June 1981.

GAO ASSESSMENT:

FNS did not resolve the audit findings in a timely manner and did not set up formal accounts receivable. FNS collection methods allow debts to "slide"--neither being collected nor written off. Starting in June 1975, FNS took no collection action for 4 years. This audit has been open for 7 years. FNS is not accruing interest which has resulted in a considerable loss in the time value of money. Grantees have nothing to lose by delaying payment. The grantee made a payment to settle a portion of this debt from an account containing Federal and non-Federal funds.

CASE NUMBER USDA-3

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

Audit Report Number and Date: 2724-32-Ch issued 12/15/78

Auditee: New Grace Missionary Baptist Church, Highland Park, Michigan

Amount Questioned: $341,486

Amount Disallowed: $341,486

Date of Disallowance: 01/08/79

Recovery Action Taken: No recovery as of 09/28/81. FNS has not pursued the debt against the State because the State could not recover from its recipient.

Appeal Status: No appeal filed.

CASE FACTS:

12/15/78 - Audit report was issued showing the subgrantee did not have records to support $341,486 received in Child Care Food Program funds from July 1975 through April 1978. The Michigan Department of Education was responsible for administering the FNS program in Michigan.

01/08/79 - A FNS official from the Midwest Regional Office requested the Michigan Department of Education to recover the unsupported reimbursements of $341,486 at the earliest possible date.

02/22/79 - Three additional follow-up letters were sent to the Michigan Department of Education.
03/26/79
07/03/79

08/01/79 - Officials of the Midwest Regional Office were informed that the audit had been referred to the Michigan Attorney General who would not respond as to its status. The Michigan State agency was unable to recover the funds from the subgrantee.

02/26/80 - FNS officials from the Midwest Regional Office again followed-up with the Michigan State agency. However, no demand for payment was made to the Michigan State agency.
06/13/80

08/08/80 - The Michigan State agency informed officials of the Midwest Regional Office that Michigan's Department of Social Services would initiate civil action against the subgrantee.

08/08/80 to 02/20/81 - No further information was recieved by FNS officials from the Michigan State agency regarding the audit. Informal communication from the State agency indicates they were having difficulty in eliciting action from the State Attorney General's Office.

02/20/81 and 05/28/81 - FNS demanded payment from the Michigan State agency.

09/22/81 - FNS requested the State Financial Control Division of FNS to reduce Michigan's letter of credit by $341,486.

PRESENT STATUS:

A claim has been established and set up as an account receivable. Michigan's letter of credit had not been reduced as of 09/26/81.

GAO ASSESSMENT:

FNS failed to aggressively pursue collection action against the Michigan State agency. FNS should have demanded payment regardless of the difficulty that Michigan was having with the subgrantee. Over 2 years lapsed from the time FNS first requested the State agency to recover the funds to the date they finally demanded payment from the State agency. Also, FNS has not accrued interest on the outstanding disallowance.

CASE NUMBER USDA-4

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service (FNS)

Audit Report Number and Date: 2723-167-Ch issued 08/03/79

Auditee: Detroit Public Schools, Child Nutrition Programs, Detroit, Michigan

Amount Questioned: $204,978

Amount Disallowed: $204,978

Date of Disallowance: 09/19/80

Recovery Action Taken: No recovery as of 11/02/81.

Appeal Status: No appeal filed.

CASE FACTS:

08/03/79 - Audit issued with questioned costs of $204,978 based on invalid applications for free meals, excess reimbursements for meals claimed not supported by valid free meal applications, etc.

09/19/79 - FNS requested the State agency to recover the funds from the subgrantee.

10/15/80 - The Michigan State agency administering the FNS program received a letter from the Detroit Public Schools advising that a check in the amount of $204,978 would be submitted to the State of Michigan.

11/25/80 - The State agency responded to the FNS Midwest Regional Office that the Detroit Public School system was experiencing a severe cash flow problem.

01/29/81 - The Detroit Public Schools remitted a check in the amount of $204,978 to the order of the State of Michigan.

11/02/81 - The State agency had not yet offset the amount recovered from the Detroit Public Schools on its request for Federal funds under letter of credit.

PRESENT STATUS:

The Inspector General's office told us there is a dispute between the State agency and the FNS Midwest Regional Office regarding the reconciliation of Federal monies given to the State agency in FY 79. FNS is withholding $300,000 from the State agency pending the results of the reconciliation. The State agency is likewise withholding payment of the debt pending the final reconciliation.

GAO ASSESSMENT:

FNS officials were slow in following up and have not aggressively pursued the debt. Collection action should be pursued against the State agency administering the FNS programs regardless of the difficulties that the subgrantee has in repaying the State agency.

CASE NUMBER USDA-5

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

Audit Report Number and Date: 2716-9-Ch issued 12/27/77

Auditee: Food Stamp Program, Illinois Department of Public Aid,
Cook County, Illinois (findings also included in audit of overall
State operations in Illinois, 2713-32-Ch, as of 12/27/77)

Amount Questioned: $16.3 million

Amount Disallowed: $16.3 million
$ 8.6 million (revised)

Date of Disallowance: 03/07/78
05/10/79 (revised)

Recovery Action Taken: None. Decision not to pursue claim 05/23/80 (see case facts).

Appeal status: No appeal filed.

CASE FACTS:

12/27/77 - USDA auditors reported that over $16 million in food coupons had been overissued in Illinois, and recommended billing the State agency.

03/07/78 - FNS wrote to the Director of the Illinois Department of Public Aid (IDPA) and stated that the $16.3 million must be viewed as a State agency fiscal liability, and that a billing was being considered.

03/13/78 - The FNS wrote to the Director of IDPA that a billing for the losses could be expected. FNS, however, did not record the debt as a receivable.

10/03/78 - A meeting was held between Agriculture's Assistant Secretary and the Director of IDPA to discuss the charges raised by the audit. It was agreed that a charge would be pursued with the dollar amount yet to be determined. A key factor would be corrective action taken by the State.

05/10/79 - OIG revised the statistical projection which reduced the disallowance to $8.6 million in a letter to the FNS Midwest Regional Administrator.

06/07/79 - The FNS acting Administrator wrote to Agriculture's Office of General Counsel recommending that the State be billed for $10.6 million, and gross negligence charges be pursued.

07/11/79 - The Office of General Counsel responded to FNS with reservations about pursuing gross negligence charges, based in part on the difference in projections of overissuance presented by OIG ($8.6 million) and FNS ($10.6 million).

12/79 - A follow-up audit by Agriculture's auditors found some improvement in the certification error rate in Cook County, Illinois.

05/23/80 - FNS Administrator wrote to the acting Director of IDPA that based on the remedial action taken by IDPA to correct past deficiencies, FNS had decided not to pursue a gross negligence charge against the State agency.

08/19/80 - The FNS Administrator requested General Counsel concurrence in not pursuing a negligence billing against Illinois. He cited Illinois' corrective action and progress in improving its computer system to rectify issuance deficiencies.

11/14/80 - The General Counsel's office notified FNS that they had no objection to the FNS decision to not pursue the claim against the Illinois State agency.

12/19/80 - FNS Headquarters concurred with the regional decision to close audit 2716-9-Ch.

PRESENT STATUS:

Case has been closed. The claim against the State has been waived by FNS officials.

GAO ASSESSMENT:

Because of the lack of accounting and collection controls at Agriculture, available records do not show clearly when a claim was established in this case. Agriculture officials, however, told us they considered it to be a claim. They said they terminated the claim on the basis of clear evidence that the State was serious about correcting deficiencies to prevent future abuse. While we would certainly expect corrective action to be taken to avoid future misuse of funds, the Claims Collection Standards do not provide for terminating claims on the basis of present or future compliance with regulations.

CASE NUMBER USDA-6

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

Audit Report Numbers and Dates:	2714-563-Ch issued 01/08/76 2713-24-Ch issued 08/13/76 27605-2-Ch issued 02/14/77 2716-4-Ch issued 02/23/78

Auditee: Food Stamp Program, Michigan Department of Social Services
Wayne County, Michigan

Amount Questioned: $3.2 million

Amount Disallowed: $3.2 million

Date of Disallowance: See GAO Assessment

Recovery Action Taken: Unrecovered as of 10/20/81

Appeal status: No appeal filed.

CASE FACTS

01/08/76 - to 02/23/78	Four audits were issued which questioned a total of $3.2 million because of certification and issuance errors made in the Food Stamp Program administered by Wayne County.
06/08/78 -	As of this date, FNS had recommended citations of gross negligence against the State agency with respect to these questioned costs on the grounds that Wayne County had a history of irregularities dating back to 1968.
04/12/79 -	A meeting was held among the Department of Agriculture's Assistant Secretary, the Michigan State Welfare Commissioner, the USDA Inspector General, and the FNS Administrator. In that meeting it was decided that substantial corrective action being implemented by the Michigan State agency would be taken into consideration in determining the disposition of the $3.2 million in potential gross negligence billings. A follow-up review by Agriculture auditors would assess the corrective actions taken by Michigan.
07/27/79 -	A subsequent audit report was issued stating, "The State agency and Wayne County have taken some action to correct the problems cited in prior audit reports, however, our review disclosed that there are still areas where the corrective action was not adequate."

CASE NUMBER USDA-6

DEPARTMENT OF AGRICULTURE
Food and Nutrition Service
Wayne County/Food Stamp Program, Michigan
Page 2

08/15/80 - Another follow-up review by Agriculture auditors was released and found the certification error rate in Wayne County to be about 24 percent and considered this unacceptable.

11/10/80 - The FNS Administrator requested Agriculture's Office of General Counsel's concurrence in forgiving the bulk of the original $3.2 million gross negligence charge. He cited follow-up audit reports which showed a decrease in the certification and issuance error rates and Michigan's good faith effort in developing and implementing corrective action to remedy its deficiencies.

08/27/81 - Agriculture's Office of General Counsel (OGC) responded to the FNS Administrator. Its opinion stated that OGC was not prepared to indicate that any portion of the $3.2 million may be waived solely on the corrective action taken by Michigan. It recommended that FNS officials reexamine the claims to determine if they should be dropped or reduced for other reasons.

09/25/81 - FNS officials recommended that charges against the Michigan State agency not be pursued because:

1. When examined individually, the loss rates involved did not meet criteria for determining gross negligence.
2. Effective corrective action was taken in good faith by the State agency on the basis of commitments made by Agriculture's former Assistant Secretary.

10/20/81 - FNS officials advised OIG officials that a decision was made not to pursue the gross negligence charge.

PRESENT STATUS:

Unrecovered. As of November 1981, OIG was preparing a rebuttal to FNS's decision not to pursue this claim.

GAO ASSESSMENT:

Because of the lack of accounting and collection controls at Agriculture, available records do not show clearly when a claim was established in this case. Agriculture officials, however, told us they considered it to be a claim. They said they terminated the claim on the basis of clear evidence that the State was serious about correcting deficiencies to prevent future abuse. While we would certainly expect corrective action to be taken to avoid future misuse of funds, the Claims Collection Standards do not provide for terminating claims on the basis of present or future compliance with regulations.

DEPARTMENT OF AGRICULTURE RESPONSE

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

RECEIVED
APR 15 1982
Legislation and National
Security Subcommittee

APR 12 1982

Honorable Jack Brooks
Chairman, Committee on Government
Operations
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your February 24, 1982, letter inviting comments on the General Accounting Office Report entitled "Federal Agencies Negligent in Collecting Debts Arising from Audits."

The issues raised in this report cause me deep concern. I am actively reviewing the Department's performance in the audit resolution process, as well as in the related debt management and internal control areas. The Department of Agriculture appreciates the opportunity to comment on the specific findings and recommendations of this report. Our responses are in the following format:

Attachment 1 - Contains actions USDA has taken to date, to comply with applicable OMB guidelines and Federal regulations;

Attachment 2 - Contains answers to the six questions in your letter of February 24, 1982;

Attachment 3 - Contains our comments on the eight recommendations in the January 22, 1982, GAO report; and

Attachment 4 - Contains the current status and a discussion of each of the six audit cases transmitted with your February 24 letter.

Please contact us if you need further clarification on this response.

Sincerely,

John E. Schrote
Assistant Secretary
for Administration

Enclosures

Attachment 1

OVERVIEW

The U.S. Department of Agriculture's policy on the collection of debts arising from audits is contained in Secretary's Memorandum No. 1720-1: "Resolution of Audits and Establishment and Collection of Claims Arising from Audits;" Departmental Notice No. 2130-1: "Requirements for the Establishment and Management of Accounts Receivables Arising from Audits," and 7 CFR Part 3015: "Uniform Federal Assistance Regulations."

On June 12, 1981, the U. S. Department of Agriculture released Secretary's Memorandum No. 1720-1 which specifically addresses the resolution of audits and establishment and collection of claims arising from audits. This policy statement reflects the Department of Agriculture's interest and concern over the need for proper and prompt resolution of audit findings, and establishing claims arising from audits. It emphasizes the need for efficient collection actions, and sets forth the Department's policy for resolving audit findings within the statutory time limits and for establishing and collecting claims.

On August 20, 1981, the Departmental Notice No. 2130-1: "Requirements for the Establishment and Management of Accounts Receivables Arising from Audits" was issued by the Assistant Secretary for Administration. This notice sets the requirements for identifying, establishing and managing accounts receivable arising from audits, and provides guidance relative to these requirements. In addition, it reiterates the Department's policy for complying with all legislative and regulatory requirements for resolving audits and establishing claims arising from them.

On November 10, 1981, 7 CFR Part 3015: "Uniform Federal Assistance Regulations" was published in the Federal Register. This represents the Department's final rulemaking on Federal assistance, and establishes policies and standards for administration of grants and cooperative agreements. USDA is legally responsible for approximately 100 Federal assistance programs. All of these programs and related activities are the result of specific authorizations and agency regulations or directives. USDA programs cover a broad spectrum of activities, encompassing direct payments, grants, cooperative agreements, subsidies, loans, loan guarantees, insurance, services, information, and property donation.

Copies of each of these three documents are attached.

(Subcommittee note.--The documents referred to have been retained in the subcommittee files.)

Attachment 2

The following are answers to the six questions attached to Congressman Brooks' letter to Secretary Block on February 24, 1982.

Each of these questions addressed policies, procedures and methods of audit resolution and debt management in the Department of Agriculture, and are answered accordingly. Specific application of each question to the Food and Nutrition Service (FNS) is also provided, as this agency was the only USDA agency included in the subject GAO audit.

1. At what point in the audit resolution process does USDA sustain a questioned cost as an audit disallowance and establish a claim? What conditions must be met?

   Answer:

   Secretary's Memorandum 1720-1 sets forth the Department's policies for resolving audit findings within the statutory time limits. It also details the USDA-wide procedures for establishing and collecting claims arising from audits. This Departmental policy says that questioned costs arising from audits are sustained and established as claims whenever Agency officials:

   (1) agree with the USDA Office of Inspector General (OIG) on the validity of the findings, the need for monetary corrective action and the amount of the claim; (procedures to resolve disagreements are in place) and

   (2) issue the auditee a Letter of Determination, citing the need for and nature of the corrective action regarding outstanding audit findings, request repayment of disallowances and set up an account receivable for the claim.

   All audits in the Department of Agriculture are required to be resolved within the time limits established in section 305 of Public Law 96-304, July 8, 1980, which requires that "any new audits involving questioned costs . . . shall be resolved within 6 months."

   In the Food and Nutrition Service, a letter of determination is issued by the Regional Administrator to the State agency within six months of issuance of a final audit report. The letter of determination cites the audit finding and specifies the amount of any claim due. The claims amount specified in the letter of determination is established in the accounting system as an accounts receivable.

Recently, FNS developed and proposed an Audit Resolution Process which is now being coordinated within FNS and OIG. In accordance with the proposed process, the OIG audit report is issued in draft to FNS for review and comment on findings and recommendations prior to issuance of the final audit report. Within 15 days from receipt of the final audit report, a letter of determination is issued by the FNS Regional Administrator to the State agency in accordance with FNS Audit Resolution procedures. When audit findings require the issuance of a negligence billing or sanction action, the matter is referred to the Administrator for review. Upon the Administrator's approval, the Letter of Determination and billing is issued within 60 days. Implementation of this Audit Resolution Process is scheduled for April 30, 1982.

2. How does the Department assure itself that the funds it receives in payment of audit disallowances are not Federal funds or do not reduce the intended benefits of USDA programs?

Answer:

The Department's policy is contained in 7 CFR Part 3015.190(a):

> "(a) Allowable costs. Grant funds may be used only for allowable costs of the activities for which the grant was awarded. This means that the total amount of money that the recipient is entitled to receive from USDA may not exceed the allowable costs incurred by the recipient for those activities."

Part 3015.103(a) and (b), concerning withholding payments states:

> "(a) Unless otherwise required by Federal statute, payments for proper charges incurred by recipients will not be withheld at any time during the grant period unless (1) the recipient has failed to comply with the program objectives, grant award conditions, or Federal reporting requirements, or (2) the recipient is indebted to the United States and collection of the indebtedness will not impair accomplishment of the objectives of any grant program sponsored by the United States, or (3) the grant is suspended pursuant to subpart N of this part."
>
> "(b) Payments withheld for failure of a recipient to comply with reporting requirements, but without suspension of the grant, will be released to the recipient upon subsequent compliance. When a grant is suspended, payment adjustments will be made in accordance with subpart N of this part. When a debt is to be collected, USDA awarding agencies may withhold payments or require appropriate accounting adjustments to recorded cash balances for which the recipient is

accountable to the Federal government, in order to liquidate the indebtedness."

FNS will explore with the Office of General Counsel the legality of including in both Child Nutrition and Food Stamp Programs a requirement for the States certification that their payment of debts owed the Federal Government shall not diminish the level of program benefits and/or services.

Within FNS, valid assurances that Federal funds are not used by States for payment of Federal claims against such States are seen as a responsibility of the grantees' designated audit agencies. Audit policy is set forth in 7 CFR Part 3015, Subpart I.

FNS is responsible for obtaining assurances that program benefits and services are not diminished as a result of the States' payments of claims assessed by the Federal government. Such assurances are incorporated in the agency's overall monitoring of program participation and performance, and through program management evaluations and administrative reviews of State agency operations.

3. Since 1979, The Federal Claim Collection Standards have required the charging of interest on all delinquent debts. Why has the Agriculture Department not been assessing interest on delinquent audit related debts? When will this requirement be fully implemented?

Answer:

Please see USDA Secretary's Memorandum 1720-1, dated June 12, 1981; and USDA Departmental Notice 2130-1, dated August 20, 1981; both of which follow Attachment 1: Overview. All USDA program agencies have been directed to charge interest on delinquent debts and debts paid in installments in conformity with the Treasury Fiscal Requirements Manual; in the absence of a different rule prescribed by statute, contract or regulation.

As noted previously, all of the USDA delinquent audit related debts that were the focus of the subject GAO Audit appear to have occurred in one agency, the Food and Nutrition Service. With regard to this particular agency's debts, the Department of Agriculture's General Counsel believes reasonable legal interpretive judgment would find USDA not legally bound to charge interest on claims arising under programs for which independent compromise authority exists, even though joint GAO and Department of Justice regulations direct affected agencies to collect interest in the manner prescribed in the Treasury Fiscal Requirements Manual (TFRM) (4 CFR 102.11).

4. What is Agriculture's position on holding grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee?

Answer:

7 CFR 3015.121 concerning "Amounts payable to the government," states that the grantee is responsible for subgrantee debts, even when the grantee cannot collect from the subgrantee. According to these regulations:

> "The following outstanding sums for each grant shall be considered as a debt or debts owed by the recipient to the Federal government. They shall, if not paid upon demand, be subject to recovery by the awarding agency from the recipient or its successor or assignees by set off or other action provided by law:"
>
> "(a) Any grant funds paid to the recipient by the Federal government which exceed the amount the recipient is finally determined to be entitled to under the provisions of the grant award;"
>
> "(b) Any interest or other investment income earned on advances of grant funds which is due the Federal government; . . ."

A "recipient," as defined in 7 CFR 3015 is "a State or local government, Federally recognized Indian Tribe, university, non-profit, or other organization that is a recipient of grants or cooperative agreements from a USDA agency."

Recipient subgrants are subjected to the same standards regarding closeout, suspension, and termination of subgrants as prescribed in 7 CFR 3015.125 for awarding agencies.

The policy of FNS is to hold States responsible for claims arising against subgrantees. The States' Agreement to participate in FNS programs and State Plans of Operation provide that States are responsible for program compliance by subgrantees. States are held responsible for subgrantee claims. However, in accordance with Section 816(b) of P.L. 97-35 and Section 13 of the Food Stamp Act of 1977 the Secretary may compromise, adjust or deny all or part of a claim when determined appropriate.

5. USDA replied to GAO's questionnaire concerning the recovery of disallowed costs that accounts receivable are established for audit disallowances. GAO's work in one of USDA's (FNS) regions, however, showed that receivables are not established. What is the actual practice in your other regions and when will accounts receivable be established for these debts universally?

Answer:

A centralized accounts receivable process was implemented in FNS in June 1981. The process contains accounts receivable nationwide. The process, which is currently manual, is scheduled to be decentralized to the FNS Regional Offices in April 1982.

An automated accounts receivable process is being designed and is targeted for implementation in August 1982. Each Region will input its accounts receivable data daily to a Regional and National data base.

6. Under what authority has USDA terminated millions of dollars in claims attributable to audit findings (in the Food and Nutrition Service)?

Answer:

Potential FNS claims arising from audit findings are not always collected. In some cases, further examination of the finding leads to the conclusion that the potential claim is not justified. This may be the result of either further development of the facts or more detailed analysis of the applicable laws and regulations. In other cases, claims are compromised on the basis of a judgment that, while FNS has a claim against a recipient, the validity or size of the claim are sufficiently open to challenge that settlement is in the best interests of the Federal government.

In addition, FNS has, in the past, for several years been involved in a program under which claims against recipients would be dropped in return for a commitment by the recipient to undertake a corrective action program which would assure that the practices which led to the claim did not reoccur. There was, however, some question as to the authority of FNS to undertake such a program. The uncertainties were resolved by provisions of the Omnibus Budget Reconciliation Act of 1981 which gave FNS the authority to waive claims arising under its programs upon a determination by the Secretary that to do so would serve the purposes of the program involved. Specifically, section 13(a) of the Food Stamp Act of 1977, as amended by section 113 of the Omnibus Budget Reconciliation Act of 1981 states:

> "The Secretary shall have the power to determine the amount of and settle and adjust any claim and to compromise or deny all or part of any such claim or claims arising under the provisions of this Act or the regulations issued pursuant to this Act, including, but not limited to, claims arising from fraudulent and nonfraudulent over-issuances to recipients, including the power to waive claims if the Secretary determines that to do so would serve the purposes of this Act. Such powers with respect to claims against recipients may be delegated by the Secretary to State agencies. The Secretary shall have the power to reduce amounts otherwise due to a State agency under section 16 of this Act to collect unpaid claims assessed against the State agency if the State agency has declined or

> exhausted its appeal rights under section 14 of this Act."

Similarly, section 16(b) of the Child Nutrition Act, as amended by section 816 of the Omnibus Budget Reconciliation Act of 1981 states:

> "Section 16(b) with regard to any claim arising under this Act or under the National School Lunch Act, the Secretary shall have the authority to determine the amount of, to settle and to adjust any such claim, and to compromise or deny such claim or any part thereof. The Secretary shall also have the authority to waive such claims if the Secretary determines that to do so would serve the purposes of either such Act. Nothing contained in this subsection shall be construed to diminish the authority of the Attorney General of the United States under section 516 of title 28, United States Code, to conduct litigation on behalf of the United States."

We believe that this legislation gives the Secretary or his designee broad legal authority to waive claims arising under such programs. Of course, it remains the responsibility of the Secretary's designee to determine in each case that the purposes of the affected program are served by such a waiver.

Attachment 3

The following comments are in response to specific recommendations of the Audit Report Transmitted by Congressman Jack Brooks. The Audit Report referenced only one USDA agency, the Food and Nutrition Service.

Recommendation 1: Require a written determination of the allowability of all questioned costs within six months of audit report issuance.

Comment: All audits in the Department of Agriculture are required to be resolved within the time limits established in section 305 of Public Law 96-304, July 8, 1980, which requires that "any new audits involving questioned costs . . . shall be resolved within 6 months."

Secretary's Memorandum 1720-1 sets forth the Department's policies for resolving audit findings within the statutory time limits. It also details the USDA-wide procedures for establishing and collecting claims arising from audits. This Departmental policy says that questioned costs arising from audits are sustained and established as claims whenever Agency officials:

(1) agree with the USDA Office of Inspector General (OIG) on the validity of the findings, the need for monetary corrective action and the amount of the claim; (procedures to resolve disagreements are in place) and

(2) issue the auditee a Letter of Determination, citing the need for and nature of the corrective action regarding outstanding audit findings, request repayment of disallowances and set up an account receivable for the claim.

All audits in the Department of Agriculture are required to be resolved within the time limits established in section 305 of Public Law 96-304, July 8, 1980, which requires that "any new audits involving questioned costs . . . shall be resolved within 6 months."

In the Food and Nutrition Service, a letter of determination is issued by the Regional Administrator to the State agency within six months of issuance of a final audit report. The letter of determination cites the audit finding and specifies the amount of any claim due. The claims amount specified in the letter of determination is established in the accounting system as an accounts receivable.

Recommendation 2: Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

Comment: On June 12, 1981, the U. S. Department of Agriculture released Secretary's Memorandum No. 1720-1 which specifically addresses the resolution of audits and establishment and collection of claims arising from audits. This policy statement reflects the Department of Agriculture's interest and concern over the need for proper and prompt resolution of audit findings, and establishing claims arising from audits. It emphasizes the need for efficient collection actions, and sets forth the Department's policy for resolving audit findings within the statutory time limits and for establishing and collecting claims arising from audits.

Recently, FNS developed and proposed an Audit Resolution Process which is now being coordinated within FNS and OIG. In accordance with the proposed process, the OIG audit report is issued in draft to FNS for review and comment on findings and recommendations prior to issuance of the final audit report. Within 15 days from receipt of the final audit report, a letter of determination is issued by the FNS Regional Administrator to the State agency in accordance with FNS Audit Resolution procedures. When audit findings require the issuance of a negligence billing or sanction action, the matter is referred to the Administrator for review. Upon the Administrator's approval, the Letter of Determination and billing is issued within 60 days. Implementation of this Audit Resolution Process is scheduled for April 30, 1982.

In the Food and Nutrition Service a centralized, manual, accounts receivable process was implemented June 1981. The amount of the bill is recorded in the accounts receivable when the letter of determination and the bill are issued.

Recommendation 3: Ensure agressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30 day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or terminaton of funding.

Comment: On August 20, 1981, the Departmental Notice No. 2130-1: "Requirements for the Establishment and Management of Accounts Receivables Arising from Audits" was issued by the Assistant Secretary for Administration. This notice sets the requirements for identifying, establishing and managing accounts receivable arising from audits, and provides guidance relative to these requirements. In addition, it reiterates the Department's policy for complying with all legislative and regulatory requirements for resolving audits and establishing claims arising from them.

A review of major Agency demand letters was completed by the Office of Finance and Management, Office of the Secretary during September 1981, as part of USDA's debt management program. In general, demand letters were found to be in compliance with sound debt management practices and the Federal Claims Collection Standards. Agencies have been notified of any deficiencies and have been requested to take appropriate action. The Office of Finance and Management will ensure implementation of recommended changes by obtaining and reviewing revised Agency demand letters.

In addition, the Office of Finance and Management is in the process of drafting a Departmental Debt Management Directive which will reinforce the need for aggressive collection action in accordance with the Federal Claims Collection Standards. This Directive will require that demand letters be issued within 30 day intervals, and we are looking into the possibility that these demand letters may contain notification that nonpayment may adversely affect the debtor's credit rating, as well as result in the possible suspension or termination of services or funding. The Directive will give specific policy regarding offsets against amounts due from other USDA programs.

FNS, in accordance with the Claims Collection Standards and the Departmental policy and instructions, issues up to three demand letters at 30 day intervals upon final determination of disallowed cost or program deficiency. It is the policy of the agency to vigorously pursue collection once a determination of indebtedness is established.

If the State cannot or refuses to pay claims assessed for disallowed costs, offsets may be imposed against other funds due the State or other action may be taken as provided by Section 13 of the Food Stamp Act of 1977 and Section 816(b) of P.L. 97-35.

Recommendation 4: Hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees.

Comment: On November 10, 1981, 7 CFR Part 3015: "Uniform Federal Assistance Regulations" was published in the Federal Register. This represents the Department's final rulemaking on Federal assistance, and establishes policies and standards for administration of grants and cooperative agreements. USDA is legally responsible for approximately 100 Federal assistance programs. All of these programs and related activities are the result of specific authorizations and agency regulations or directives. USDA programs cover a broad spectrum of activities, encompassing direct payments, grants, cooperative agreements, subsidies, loans, loan guarantees, insurance, services, information, and property donation.

The Department's policy is contained in 7 CFR Part 3015.190(a):

"(a) Allowable costs. Grant funds may be used only for allowable costs of the activities for which the grant was awarded. This means that the total amount of money that the recipient is entitled to receive from USDA may not exceed the allowable costs incurred by the recipient for those activities."

Part 3015.103(a) and (b), concerning withholding payments states:

"(a) Unless otherwise required by Federal statute, payments for proper charges incurred by recipients will not be withheld at any time during the grant period unless (1) the recipient has failed to comply with the program objectives, grant award conditions, or Federal reporting requirements, or (2) the recipient is indebted to the United States and collection of the indebtedness will not impair accomplishment of the objectives of any grant program sponsored by the United States, or (3) the grant is suspended pursuant to subpart N of this part."

"(b) Payments withheld for failure of a recipient to comply with reporting requirements, but without suspension of the grant, will be released to the recipient upon subsequent compliance. When a grant is suspended, payment adjustments will be made in accordance with subpart N of this part. When a debt is to be collected, USDA awarding agencies may withhold payments or require appropriate accounting adjustments to recorded cash balances for which the recipient is accountable to the Federal government, in order to liquidate the indebtedness."

Within FNS, valid assurances that Federal funds are not used by States for payment of Federal claims against such States are seen as a responsibility of the grantees' designated audit agencies. Audit policy is set forth in 7 CFR Part 3015, Subpart I.

FNS is responsible for obtaining assurances that program benefits and services are not diminished as a result of the States' payments of claims assessed by the Federal government. Such assurances are incorporated in the agency's overall monitoring of program participation and performance, and through program management evaluations and administrative reviews of State agency operations.

States are held responsible for claims arising against subgrantees. The States' Agreements to participate in FNS programs and State Plans of Operation provide that States are responsible for program compliance by subgrantees. It is current policy to hold States responsible for subgrantee claims. However, in accordance with section 816(b) of P.L. 97-35 and section 13 of the Food Stamp Act of 1977, the Secretary may compromise, adjust or deny all or part of a claim when determined appropriate.

Recommendation 5: Ensure compliance with the Claims Collection Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

Comment: The Department is in the process of developing a draft debt management directive which will ensure compliance with the Federal Claims Collections Standards to preclude the termination of any debts over $20,000, and ensure that all Federal Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

FNS policy and instructions on audit resolution and maintenance of related accounts receivable incorporate the applicable provisions and intent of the Claims Collection Standards. However, the Omnibus Reconciliation Act of 1981 (P.L. 97-35) grants authority to the Secretary to waive or adjust any claim arising under the Child Nutrition Act if the Secretary determines that to do so would serve the purposes of the Child Nutrition Act or the Omnibus Reconciliation Act. Section 13 of the Food Stamp Act of 1977 provides. . .

> "The Secretary shall have the power to determine the amount of and settle and adjust any claim and to compromise or deny all or part of any such claim or claims arising under the provisions of the Act or the regulations issued pursuant to the Act, including, but not limited to, claims arising from

> fraudulent and nonfraudulent overissuances to recipients. Such powers with respect to claims against recipient may be delegated by the Secretary to State agencies (7 U.S.C. 2022)."

Recommendation 6: Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

Comment: The appeals process is described by FNS regulations. The regulations and appeal processes will be reviewed to determine if changes are needed to eliminate unneccessary delays. The portion of the recommendation dealing with charging States interest on debts under formal appeal is addressed below.

Recommendation 7: Require interest be charged on all amounts under appeal. Require interest to be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition.

Comment: The question of whether interest should be charged on FNS claims was presented to USDA's General Counsel (OGC). It is the opinion of the Departments's General Counsel, based on current legislation, that the Secretary is not legally bound to charge interest on claims under programs for which independent compromise authority exists even though the joint GAO/Department of Justice regulations direct affected agencies to collect interest in the manner prescribed by Treasury.

Section 13(a) of the Food Stamp Act of 1977, as amended by section 113 of the Omnibus Budget Reconciliation Act of 1981 states:

> "The Secretary shall have the power to determine the amount of and settle and adjust any claim and to compromise or deny all or part of any such claim or claims arising under the provisions of this Act or the regulations issued pursuant to this Act, including, but not limited to, claims arising from fraudulent and nonfraudulent overissuances to recipients, including the power to waive claims if the Secretary determines that to do so would serve the purposes of this Act. Such powers with respect to claims against recipients may be delegated by the Secretary to State agencies. The Secretary shall have the power to reduce amounts otherwise due to a State agency under section 16 of this Act to collect unpaid claims assessed against the State agency if the State agency has declined

> or exhausted its appeal rights under section 14 of this Act."

Similarly, section 16(b) of the Child Nutrition Act, as amended by section 816 of the Omnibus Budget Reconciliation Act of 1981 states:

> "Section 16(b) with regard to any claim arising under this Act or under the National School Lunch Act, the Secretary shall have the authority to determine the amount of, to settle and to adjust any such claim, and to compromise or deny such claim or any part thereof. The Secretary shall also have the authority to waive such claims if the Secretary determines that to do so would serve the purposes of either such Act. Nothing contained in this subsection shall be construed to diminish the authority of the Attorney General of the United States under section 516 of title 28, United States Code, to conduct litigation on behalf of the United States."

We believe that this legislation gives the Secretary or his delegate broad legal authority to waive claims arising under such programs.

Recommendation 8: Require grantees to certify that their payment of audit-related debt does not reduce the level of benefits of any Federal program and institute program and audit follow-up.

Comment: The Department's policy is contained in 7 CFR Part 3015.190(a):

> "(a) Allowable costs. Grant funds may be used only for allowable costs of the activities for which the grant was awarded. This means that the total amount of money that the recipient is entitled to receive from USDA may not exceed the allowable costs incurred by the recipient for those activities."

Part 3015.103(a) and (b), concerning withholding payments states:

> "(a) Unless otherwise required by Federal statute, payments for proper charges incurred by recipients will not be withheld at any time during the grant period unless (1) the recipient has failed to comply with the program objectives, grant award conditions, or Federal reporting requirements, or (2) the recipient is indebted to the United States and collection of the indebtedness will not impair accomplishment of the objectives of any grant program sponsored by the United States, or (3) the grant is suspended pursuant to subpart N of this part."

"(b) Payments withheld for failure of a recipient to comply with reporting requirements, but without suspension of the grant, will be released to the recipient upon subsequent compliance. When a grant is suspended, payment adjustments will be made in accordance with subpart N of this part. When a debt is to be collected, USDA awarding agencies may withhold payments or require appropriate accounting adjustments to recorded cash balances for which the recipient is accountable to the Federal government, in order to liquidate the indebtedness."

FNS will explore with OGC the legality of including in both Child Nutrition and Food Stamp Programs a requirement for the States certification that their payment of debts owed the Federal Government shall not diminish the level of program benefits and/or services.

Within FNS, valid assurances that Federal funds are not used by States for payment of Federal claims against such states are seen as a responsibility of the grantee's designated audit agencies. Audit policy is set forth in 7 CFR Part 3015, Subpart I.

FNS is responsible for obtaining assurances that program benefits and services are not diminished as a result of the States' payments of claims assessed by the Federal government. Such assurances are incorporated in the agency's overall monitoring of program participation and performance, and through program management evaluations and administrative reviews of State agency operations.

Attachment 4

Current status and explanations on the six specific audit cases transmitted with Congressman Brooks' letter.

Food Stamp Program
Santa Clara County, California
Audit Report No. 2714-59-SF

This audit report was released on February 3, 1972. The auditors found that there was $713,272 in cash and coupon differences between the county and issuing agency's recordings of transactions. The auditors recommended that the State agency, "strengthen data processing controls to insure the timely reconciliation of differences between the county and issuing agents' records; and resolve unaccounted for differences in cash and coupons since July 1970". It should be noted that the auditors did not recommend that the State be billed for the total amount.

On the advice of the Department's Office of the General Counsel, this audit was held open for a number of years as back-up to a pending gross negligence charge. When a concentrated effort to close audits was made, the State was billed for the total unreconciled amount as reported by the auditors.

In their review, FNS found that the auditors had considered only the first reconciliation run. The second reconciliation tape showed that less than one percent of the total issuance was unreconciled. The highest unreconciled amount occurred in July 1971, and even that amount was less then one percent. The State agency reconciled further for six of the fifteen months, including July 1971. For these six months, the State was able to reduce the cash discrepancy from $121,190 to $13,463 and the coupon discrepancy from $469,608 to $39,305 for a revised total of $52,768. The State agency felt that further reconciliation for the remaining nine months would be time consuming and unproductive.

Based on the above, the agency recommended that no claim be established for the nine months that were never fully reconciled. Because of the time that had elapsed, the State agency was not able to go back and reconcile. Further, based on the six-month sample, unreconciled amounts as shown in the audit greatly overestimated actual losses. For the six months that the State agency did reconcile further, there was a loss of $52,768. We recommended that the State be held liable for this amount. Accordingly, the amount of the claim was reduced from $713,272 to $52,768. The $52,768 was billed to the State and collected.

Food Stamp Program
Wayne County Michigan
Audit Report No 2714-563-CH

This potential charge was based on losses cited in four audits (2714-563-Ch, 2713-24-Ch, 27605-2-Ch and 2716-4-Ch). The projected losses totaled approximately $3.2 million and covered the periods April through March 1975 and July 1975 through July 1977.

Prior to the final decision not to pursue a gross negligence charge, we were advised by the Office of the General Counsel (OGC) that neither the Food Stamp Act nor the gross negligence regulations in effect at the time of the losses automatically required pursuing a collection action. In essence, OGC advised a programmatic resolution of the potential claims by examining each loss type individually against the agency's criteria at the time the losses occurred to determine if the State agency was grossly negligent. FNS' policy was such that consideration would be given to establishing a gross negligence charge if the dollar loss rate cited in an audit exceeded five percent. We determined that none of the losses cited in the four audits met our criteria for establishing gross negligence, if viewed from the perspective of dollar loss rates. The following is a breakdown by type of loss, amount and dollar loss rate:

	Type of Loss	Amount	Loss Rate
1.	Computer Tapes Processed Twice	$ 56,999	1.3%
2.	Excessive ATP Issuances	$ 17,073	less than 1%
3.	Replacement ATP's	$ 157,704	less than 1%
4.	Certification Losses	$ 516,231	3.9%[1/]
5.	Overdue Recertifications	$1,314,678	1.36%
6.	Zero Purchase Cards at Incorrect Basis of Issuance	$ 7,526	less than 1%
7.	Lack of Documentation to Support Issuance	$ 151,812	1.5%

It should also be pointed out that, as in the case of the Illinois potential charge, at an April 12, 1979, meeting between the then Assistant Secretary for Food and Consumer Service, the Michigan State Welfare Commissioner, and the then USDA Inspector General, it was decided that substantial corrective action being implemented by the Michigan State agency would be taken into consideration in determining the disposition of the potential charge. Subsequent to this meeting, follow-up audits by the Office of Inspector General (OIG) and several monitoring reviews by our Midwest Regional Office in Chicago revealed that significant progress had been made in improving all areas cited in the potential charge. At the September 26, 1980, FNS-OIG Audit Review Committee meeting, OIG stated that there had been substantial improvement in Michigan and that FNS could take actions it deemed appropriate to close out the four audits on which the potential charge was based.

[1/] This reflects a reduction from the original projected dollar loss of $1,530,160 at a rate of 11.58 percent. This figure was reduced by excluding 24 cases (12 for missing case records and 12 for improper classifications). It was not our policy to include these types of errors in loss projections when determining if a State was negligent, since it is not clear in these types of cases that there has been a loss of Federal funds.

Food Stamp Program
Cook County and State Operations
Audit Report No. 2716-9-CH, Illinois

In Audit Report No. 2716-9-Ch, issued March 1978, the Office of Inspector General (OIG) projected certification and issuances losses in Cook County during the periods July 1974 through December 1975 and April 1976 through September 1977 in the amount of $16,376,746. The inadequacy of the Illinois State agency's centralized ADP system directly contributed to its failure to identify excessive food stamp participation.

In the areas of certification, the initial projected overissuance was reported as $9,440,243. Issuance losses were projected to have amounted to $6,927,503, with a total projected loss to the program equalling $16,367,746. Subsequently, OIG reduced the amount of losses originally attributable to certification errors by recategorizing 12 sample cases from error to nonerror cases. The deletion of these cases reduced the initial projection by $860,478. Thus, OIG's audit reprojection amounted to $15,507,268. Additionally, OIG had included as certification errors five categories of technically ineligible cases which the Office of the General Counsel (OGC) initially questioned, or has historically questioned, since the issuance may not in fact have represented an actual loss to the program. Thus, $4,876,415 was extrapolated from the audit reprojection resulting in an adjusted audit reprojection of $10,630,853.

In releasing a prior Cook County audit (No. 2714-585-Ch) to the State agency on May 7, 1976, we advised the State agency of our concerns about the high, on-going incidence of deficiencies and allowed the State six months (until November 1976) for corrective action before another audit would be conducted and a billing established for continuing losses. On this basis, the excess participation losses amounting to $4,927,993 which occurred prior to November 1976 were excluded from the potential gross negligence charge. Eliminating these losses further reduced the potential billing to $5,702,860.

In October 1978 the then Assistant Secretary for Food and Consumer Services informed the Director of the Illinois State agency, that a key factor in determining Illinois' liability would be corrective action by the State and that exceptional corrective action would be credited by the Department in reaching a final disposition on the State's liability. The State subsequently projected a certification dollar loss rate of less than 0.1 percent. OIG also noted that Illinois had made substantial progress in improving its computer capability to rectify issuance deficiencies.

Therefore, based on the responsible Assistant Secretary commitment at the time, the decision was made not to pursue the $5,702,860 potential charge due to the State's exceptional efforts in implementing effective corrective action. OGC advised it would not object to the decision on October 3, 1980.

Child Nutrition Programs

Los Angeles Unified School District
Audit Report No. 60235-2

GAO is correct in its assessment that resolution of this audit has not been timely. However, FNS/Western Regional Office staff has worked closely with the State agency in efforts to resolve the audit findings. Meeting reports and memoranda between the State agency and the Western Regional Office document these efforts. Based on additional documentation provided by the school district, the overclaim for this audit was reduced from $1,343,291.56 to $1,268,982. The State agency collected $154,185 from the school district leaving an outstanding balance of $1,114,707. Offset of the overclaim from the State Agency's Letter-of-Credit was scheduled to begin in February 1982. However, the State agency filed a complaint against the Department and collection action has been suspended to allow the State agency and the Department to prepare for a hearing.

Detroit Public Schools
Audit Report No. 2723-167-CH

GAO assessment is correct. During a recent Management Evaluation review in Michigan, the Regional Office discussed the issue of the offset with the State agency. The Regional Office was advised by the State agency that the matter would be cleared up by the end of March.

Based on a telephone discussion with the FNS regional office on March 15, 1982, the program director was advised that the State agency plans to issue a check in the amount of the overclaim ($204,978).

New Grace Missionary Baptist Church
Audit Report No. 2724-32-CH

Recovery of the claim ($341,486) was accomplished on October 2, 1981, through a Letter-of-Credit reduction only six days after completion of the survey performed by GAO. This action had already been initiated before GAO had completed the survey.

CASE EXAMPLES SUBMITTED TO THE DEPARTMENT OF EDUCATION

CASE NUMBER DOEd-1

DEPARTMENT OF EDUCATION

Program: Indian Education Act

Audit Report Number and Date: 09-60102 issued 12/31/75

Auditee: Chinle School District #24 (Arizona)

Amount Questioned: $163,431

Amount Disallowed: $163,431

Date of Disallowance: 08/25/77

Recovery Action: $164,446.73 repaid by check 07/80 ($163,431 plus $1,225.73 in interest)

Appeal Status: Grantee appealed $163,431 on 09/08/77. Appeal resolved on 06/29/79 in the agency's favor.

CASE FACTS:

12/31/75 - Audit report issued.

08/11/76 - Office of Indian Education advised grantee of audit findings.

08/25/77 - Office of Indian Education notified grantee to refund $163,431 within 30 days due to failure to respond to 08/11/76 communication.

09/08/77 - Grantee appealed disallowance.

06/14/78 - Finance advised to establish an account receivable for $163,431 - but hold collection action because of appeal.

06/29/79 - Grant Appeals Board issued decision denying the appeal.

09/19/79 - Finance advised to initiate collection.

04/09/80 and 05/30/80 - Finance sent demand letters.

07/01/80 - Check for $164,656.73 received (included principle and $1,225.73 in interest).

PRESENT STATUS:

Closed, disallowance recovered.

GAO ASSESSMENT:

Education lost almost a year's interest due to slowness in following-up collection activity once the appeal was decided. There was considerable delay in the resolution process—giving the grantee a full year to respond to the audit findings before sustaining the disallowance. The grantee was also able to delay payment for almost 2 years through the appeal process.

CASE NUMBER DOEd-2

DEPARTMENT OF EDUCATION

Program: Title I, Elementary and Secondary Education Act

Audit Report Number and Date: 10-70004 issued 12/23/76

Auditee: Washington State Superintendent of Public Instruction

Amount Questioned: $295,016

Amount Disallowed: $ 92,134

Date of Disallowance: Approximately 08/22/77

Recovery Action: None as of October 1981.

Appeal Status: Education Appeal Board has no record of appeal, but finance office has case in "appeal/pending" status.

Date and Amount of Appeal: Unknown

CASE FACTS:

12/23/76 - Audit report issued with questioned costs of $295,016 for the period 07/01/73 - 06/30/75.

Undated - $92,134 disallowed in letter to Washington.

09/27/77 - Finance office established an account receivable; told to hold collectior action until further notification by Audit Liaison and Coordination Staff due to appeal.

PRESENT STATUS:

The finance office has the case in an appeal status. However, the Education Appeal Board does not have the case on its docket (either as an open or finalized appeal).

GAO ASSESSMENT:

This case has been floating for 4 years. If payment was made to the program office, Finance is unaware of it and has not closed out the account. No action has been taken to pursue collection.

CASE NUMBER DOEd-3

DEPARTMENT OF EDUCATION

Program: Title I, Elementary and Secondary Education Act

Audit Report Number and Date: 05-10403 issued 06/16/71

Auditee: Michigan State Department of Education

Amount Questioned: $84,201

Amount Disallowed: $55,557

Date of Disallowance: 08/09/74

Recovery Action: No recovery as of 10/23/81

Appeal Status: Grantee appealed $55,557 on 9/6/74. Appeal decided in agency's favor on 2/27/80.

CASE FACTS:

06/16/71 - Audit report issued which questioned costs of $84,201 relating to improper accounting for Title I migrant program funds ($28,644) and incorrect charging of day care expenses to the migrant program ($55,557).

06/20/73 - $84,201 was disallowed in the Preliminary Letter of Determination.

07/20/73 - Michigan responded with sufficient information for Education to close the matter involving $28,644; $55,557 remained open for settlement.

08/09/74 - Disallowance letter for $55,557 sent to grantee.

09/06/74 - Michigan requested review of the disallowance by the "Title I Audit Hearing Board."

09/30/76 - Michigan again requested review.

12/06/77 - Michigan and Deputy Commissioner for School Systems of the U.S. Office of Education each filed initial briefs.

02/12/79 - The Board's Panel issued Interim Decision in Appeal of the State of Michigan, and concluded that Michigan must refund the amount of Title I migrant funds improperly expended on the day care program. Further proceedings necessary to determine correct amount.

12/19/79 - Panel issued Final Decision (sent to Commissioner of Education). Michigan should submit $55,557 to the U.S. Office of Education.

02/27/80 - Michigan was advised that the panel's decision was now final (60-day period for comment and review by Commissioner had expired), and refund of $55,557 was required.

03/17/80 - Department of Education finance office sent Michigan demand letter for $55,557.

CASE NUMBER DOEd-3

DEPARTMENT OF EDUCATION
Michigan State Department of Education
Page 2

04/02/80 - Michigan advised that funds had not yet been appropriated for the debt and indicated the State wished to discuss alternative methods for Michigan to repay.

07/21/80 - Department of Education finance office informed Michigan of alternatives for repayment:

1. Payment within 30 days of 07/21/81 in one lump sum or interest would accrue.
2. If a special State bill is necessary, payment of $55,557 within 30 days of the bill becoming law or interest would accrue.
3. Offset against cash drawdowns if Michigan replaced the funds to Office of Education programs.

10/23/81 - Department of Education finance office followed up on 07/21/80 letter. Michigan said a response had been sent (dated 07/29/80); Accounts Receivable Section had no knowledge of the letter. Michigan said it would send a copy of the 07/29/80 letter to the Accounts Receivable Section.

PRESENT STATUS:

Case is open as of 10/23/81. Collection is anticipated but may be delayed.

GAO ASSESSMENT:

Extensive delay was encountered in the appeals process (September 1974-February 1980). Once the appeal was settled, Education failed to aggressively pursue collection. The debt has been outstanding for over 7 years; there has been adequate time for Michigan to enact legislation if necessary. Education should actively pursue collection efforts to include charging interest on the debt.

CASE NUMBER DOEd-4

DEPARTMENT OF EDUCATION

Program: Title I, Elementary and Secondary Education Act

Audit Report Number and Date: 09-00002 issued 10/05/79

Auditee: California State Department of Education

Amount Questioned: $28.7 million

Amount Disallowed: $28.7 million

Date of Disallowance: 11/26/79

Recovery Action: No recovery as of 11/30/81.

Appeal Status: $28.7 million appealed on 01/28/80. Under appeal as of 11/30/81.

CASE FACTS:

10/05/79 - Audit report issued with questioned costs of $28.7 million for the period 07/01/74-06/30/78. Auditors found that pupils served by Title I were sometimes denied funding they were entitled to under the State-mandated Educationally Disadvantaged Youth Act Program. As a result, about $28.7 million in Title I funds was used to supplant, rather than supplement, State funds.

11/26/79 - California notified of $28.7 million disallowance.

01/28/80 - California appealed the case to the Education Appeal Board.

PRESENT STATUS:

Open, under appeal as of 11/30/81. Negotiations continue between the State and the Assistant Secretary for Elementary and Secondary Education to settle the case outside the appeal process.

GAO ASSESSMENT:

Extensive delays have been encountered in the appeals process. The legality of the Education Appeal Board's regulations is of major concern to the settlement of this case. However, the case may be settled outside the appeals process. This large disallowed amount has been outstanding for over two years.

DEPARTMENT OF EDUCATION

CASE NUMBER DOEd-5

Program: Title I, Elementary and Secondary Education Act

Audit Report Number and Date: 03-50002 issued 1/16/75

Auditee: Pennsylvania State Department of Education

Amount Questioned: $25.4 million

Amount Disallowed: $25.4 million
$ 4.6 million (revised)

Date of Disallowance: 12/7/76
01/18/80 (revised)

Recovery Action: Disallowance reduced to $4.6 million by interpretive rule (see below).

Appeal Status: $25.4 million appealed on 01/05/77. Under appeal as of October 1981.

CASE FACTS:

01/16/75 - Audit report issued with questioned costs of $25.4 million for the school district of Philadelphia because the local educational agency was not providing comparable services to non-target and target elementary schools, as required by Title I.

12/07/76 - Pennsylvania notified of $25.4 million disallowance.

01/05/77 - State appealed disallowance to Title I Audit Hearing Board.

07/06/79 - Interpretive rule published which allowed reduction of the debt.

01/18/80 - Education Appeal Board approved reduction to $4.6 million of the $25.4 million debt. (The Education Appeal Board was the successor to the Title I Audit Hearing Board.)

04/08/80 - Board's Panel ordered an Evidentiary Hearing to begin 05/21/80.

11/05/80 - Panel rescheduled Evidentiary Hearing, originally planned for 05/21/80, to 01/12/81.

12/16/80 - Panel postponed Evidentiary Hearing until 03/03/81.

02/25/81 - Secretary of Education ordered the Evidentiary Hearing postponed until further notice.

PRESENT STATUS:

The Education Appeal Board is awaiting word from the Secretary of Education to allow the Board to go forward in the case (per order of 02/25/81). As of October 1981, no word has come from the Secretary.

GAO ASSESSMENT:

As of October 1981, the case has been under appeal for over 4 and 1/2 years. Legal complications have contributed to the delays in settling the case. Education should actively pursue resolution of this matter to bring the seven year old case to a conclusion as soon as possible.

DEPARTMENT OF EDUCATION RESPONSES

THE SECRETARY
WASHINGTON, D.C. 20202

APR 5 1982

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APR 6 1982
Legislation and National
Security Subcommittee

RECEIVED
APR 5 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

The Honorable Jack Brooks
Chairman
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your recent letter transmitting for our review and comment the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits." We will provide a full response to the report findings and the other issues raised in your letter in the near future. In the meantime, responses to the specific questions enclosed with your letter are provided below.

1. At what point in the audit resolution process does the Department of Education sustain a questioned cost as an audit disallowance and establish a claim? What conditions must be met?

   A questioned cost is sustained after a designated audit resolution specialist has exhausted, in negotiations, all possible efforts to obtain information, documents, or other data available from the grantee/contractor or the government itself which would provide evidence that the cost questioned was in fact properly incurred by the grantee/contractor. Upon completion of these negotiations, a final letter of determination (FLD) is issued by the Audit Resolution Grant/Contracting Officer establishing the claims of the Government.

   For "no-opinion costs," i.e., those costs which the auditor questions, but does not indicate may be unallowable, unauthorized or illegal, we are authorized to negotiate a "fair and reasonable" settlement agreeable to both parties. For "unallowable, unauthorized, or illegal" cost findings, we are not authorized to waive or otherwise forgive any such costs which remain "unallowable, unauthorized, or illegal" after evidence, if any, received during negotiations fails to prove that such costs were in fact allowable, authorized, or otherwise legal.

If the exceptions are against Student Financial Aid (SFA) grants, the FLD is the final word and the auditee is usually given 60 days to comply. The Department's Financial Management Service (FMS) records an accounts receivable in memorandum form if collection is to be effected by expenditure adjustment, or in a collection account if repayment is to be required. On exceptions against non-SFA grants, the FLD routinely advises the auditee that they have 30 days to appeal the final decision before the Departmental Appeals Board. FMS records an accounts receivable in a suspense account pending outcome of the appeals process. After 30 days, if an appeal has not been filed, or after the Appeals Board's decision to sustain all or part of the determined amount, FMS transfers the receivable to a collection account and issues a demand letter, giving the debtor 30 days to repay.

2. How does the Department assure itself that the funds it receives in payment of audit disallowances are not Federal funds or do not reduce the intended benefits of DOE programs?

Every demand for repayment, and particularly the incremental repayment agreements, expressly direct that funds to repay ED may not come from any Federal account except when accountability is not required such as in revenue-sharing. Where collection is made by off-set against amount(s) due the grantee, the level of authorization is not reduced and the debtor is required to deposit funds in the grant accounts from non-Federal sources and to reflect such amounts on financial reports as an advance from ED. Verification that our instructions have been followed can only be done on-site, which we do through spot checks and future audits by the Inspector General's Office. The Department realizes that this method of verification may be less than satisfactory, particularly in periods of limited staff resources, and therefore is exploring alternative means of verifying proper repayment by auditees.

3. Since 1979, the Federal Claims Collection Standards have required the charging of interest on all delinquent debts. Why has the Education Department not been assessing interest on delinquent audit-related debts? When will this requirement be fully implemented?

The Department has been assessing interest on delinquent accounts receivable. Every initial demand letter carries a provision that if payment is not received in 30 days, interest will begin to accrue at a rate established by the Treasury Department. Every repayment agreement provides that if payments are not made on time, a delinquent charge will be assessed. We have no authority to assess interest until after the 30-day demand period, even though the amount due has been improperly held by the recipients for an extended period of time. This issue is under discussion with the Department of Treasury to determine if some form of legislative remedy should be proposed. In addition to including interest charges and late payment penalty requirements in demand letters and repayment agreements, the Department is considering inclusion of such requirements in final letters of determination so as to give auditees early warning of these potential additional repayment costs.

4. What is Education's position on holding grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee?

Departmental regulations are quite clear in holding the grantee responsible for the acts of their selected subgrantee. This is a fiduciary responsibility that we believe should not be altered.

5. GAO's review reported that records for 49 audit-related debts could not be located by the finance office. What is Education doing to locate these records, take necessary corrective action, and assure that, in the future, cases are monitored to prevent loss of control over receivables?

GAO provided a list of the 49 audits by Audit Control Number and they are now being researched by the Accounts Receivable Section in our finance office. At this writing 20 cases have been located in our closed file, with all actions completed. Seven additional cases have been identified and placed in the open file with collection action in process. The remaining 22 cases remain unidentified and we are attempting to trace them through records of the Inspector General's Office. The absence of a systematic tracking system for audits in process of resolution has made it difficult to control the status of audit exceptions. The Inspector General's Office is in process of developing a system that will track audits through issuance of the final determination. The Department is also evaluating alternative means by which tighter controls can be placed on the tracking of follow-up actions subsequent to the final determination. We anticipate installation of such controls by mid-summer of 1982.

6. If Education continues to utilize the Departmental Federal Assistance Financing System (DFAFS), how will cases be monitored to verify that auditees have repaid their debts?

   ED is in process of disengaging from the HHS Departmental Federal Assistance Financing System (DFAFS) with total withdrawal expected by July 1, 1982. An initial withdrawal of approximately 5,000 recipients is taking place as of March 31, 1982, with the remaining recipients, totaling approximately 2,000, to be withdrawn as of June 30, 1982. To accommodate this, ED has developed and is implementing a payment system utilizing modern technologies of automation including automated check tapes and electronic fund transfers. This will facilitate our efforts to record and track audit exceptions.

In early March of this year the Education Department initiated an extensive study of our audit follow-up system. Additional staff have been detailed to this effort which is aimed at identifying current weaknesses and designing alternatives for strengthening all phases of our follow-up program, particularly the collection of audit-related debts. We are working closely with the Office of Management and Budget under OMB's current audit resolution and debt collection initiatives. In this regard, we appreciate the Committee's interest and the assistance of the General Accounting Office in identifying areas where improvement is necessary.

Thank you again for your continued interest and support.

Sincerely,

T. H. Bell

THE SECRETARY
WASHINGTON, D.C. 20202

RECEIVED
JUL 12 1982
Legislation and National
Security Subcommittee

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JUL 2 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for the opportunity to review and comment on the recent report by the Comptroller General entitled, "Federal Agencies Negligent in Collecting Debts Arising From Audits." The Education Department's response to each of the report recommendations is enclosed, as is a current status report on the five Education Department audit cases highlighted in the GAO report.

The assistance provided by GAO in improving Federal audit follow-up practices is appreciated. This report is particularly helpful in that it represents a thorough in-depth analysis of the policy as well as operational factors inhibiting effective collection of audit-related debts. The recommendations contained in the report are serving as a guide to many of this Department's audit follow-up improvement efforts, and I am convinced that with the continued support and assistance of the General Accounting Office, these efforts will be successful.

Sincerely,

T. H. Bell

Enclosures

U.S. Education Department Response to:

The Comptroller General's Report
"Federal Agencies Negligent in
Collecting Debts Arising From Audits"

1) GAO Recommendation:

Require a written determination of the allowability of all questioned costs within six months of audit report issuance.

ED Response:

The Department concurs with this recommendation and is implementing procedures to ensure compliance. We expect the procedures to be implemented by mid-summer, 1982.

2) GAO Recommendation:

Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

ED Response:

Department policy has required since 1977 that accounts receivable be established immediately upon issuance of the Final Letter of Determination, but procedures have not existed to facilitate and monitor the application of the policy. ED Management has recently focused on requiring improved performance in this specific area as part of the Department's overall effort to implement credit management and debt collection improvements. Procedures now being implemented will require the prompt transmittal of final letters of determination from the issuing office to the office responsible for establishing accounts receivable and will establish a reporting system to monitor performance and provide data for follow-up action. We expect these procedures to be fully operational by mid-summer of this year.

3) GAO Recommendation:

Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of funding.

ED Response:

The Department concurs with this recommendation, which calls for four separate actions. Regarding the first, issuance of demand letters at 30-day intervals, Department procedures have, for the last five years, been in line with Claims and Collections Standards. However, as in the case of the previous recommendation, we have not followed this policy as a standard practice in the past. We have recently focused on improving our practices as part of our overall effort to improve our debt collection performance and are now in substantial compliance with the Department's established policy and the Claims and Collections Standards.

We support the second proposed action, affecting debtors' credit rating, and are researching our legal authority to take such action. An initial inquiry to our Office of General Counsel revealed that the Secretary of Education has no general authority to refer debtor information to credit bureaus. However, we have requested that counsel perform a statute-by-statute review to determine whether specific authority exists for some programs. We are aware that Federal debt collection legislation now pending in the Congress provides general authority to refer debtor information to credit bureaus. Should our counsel's review identify specific legal authority or should the proposed Federal legislation be enacted, we will move immediately to establish procedures whereby debtors' credit performance can be reported to credit agencies.

With respect to the remaining two suggested actions, offsetting against amounts due from other Federal programs and suspension or termination of funding, the Department currently exercises offset within programs it controls. Suspension or termination of funding, or change in the method of payment, are also employed to force compliance with demand letters.

4) GAO Recommendation:

Hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees.

ED Response:

The Department concurs with this recommendation. Department policy was formalized in 1977 to hold grantees fully responsible in this area and we have been abiding by that policy since that time.

5) GAO Recommendation:

Ensure compliance with the Claims Collection Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

ED Response:

Department policies and procedures concerning debt termination are in line with Claims and Collections Standards.

6) GAO Recommendation:

Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

ED Response:

The Department agrees that improvements can be achieved in our audit appeals process. The Office of the Inspector General in ED will perform a management audit of the appeals process this summer which, we believe, will identify specific needed improvements. It is our intention to act on the IG's findings as soon as they are available.

Concerning the recommendation that interest be charged on audit amounts under appeal, our Office of General Counsel advises that charging interest during the period in which an audit is under appeal would violate an appellant's right to due process. We plan, therefore, to implement a policy that will allow interest to accrue during the appeal period and require payment of accrued interest if/when the appeal is lost. Barring any legal impediments, we expect this policy change to take effect by the end of the current fiscal year.

7) GAO Recommendation:

Require interest to be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition.

ED Response:

Present Department policy is in line with this recommendation, and we are considering procedures to improve our performance. It is ED's policy to charge interest at the Treasury rate.

8) GAO Recommendation:

Require grantees to certify that their payment of audit-related debts does not reduce the level of benefits of any Federal program and institute program and audit follow up.

ED Response:

The Department has always required certification as called for in this recommendation. We monitor this matter to the best of our ability within resource limitations and, in cases where we belive non-compliance exists, call for special audits of grantee performance.

In addition to stating these recommendations, the Comptroller General also reported that records for 49 audit-related debts could not be located in ED. Since issuance of the GAO report, 20 of these cases have been located in the closed file and an additional seven cases have been identified and placed in the active file with collection actions in process. We are continuing our efforts to locate the remaining 22 cases.

CASE NO. 1

ACN 09-60102 Indian Education Act
Chinle School District, Arizona

GAO COMMENT

Present Status: Closed, disallowance recovered.

GAO Assessment: Education lost almost a year's interest due to slowness in following-up collection activity once the appeal was decided. There was considerable delay in the resolution process — giving the grantee a full year to respond to the audit findings before sustaining the disallowance. The grantee was also able to delay payment for almost two years through the appeals process.

ED Response : Considerable time, approximately two and a half months, was lost as a result of delay in processing documentation from the HEW Grant Appeals Board through the Audit Liaison and Coordination Staff and the relevant program to the Accounts Receivable staff. Also, several months were lost because of delays by Accounts Receivable staff in billing the auditee. Improvements have since been made and others are underway to facilitate more timely processing of documentation to the Accounts Receivable staff and more aggressive collection action.

CASE NO. 2

ACN 10-70004 Washington State Superintendent of Public Instruction

GAO COMMENT

Present Status: The Finance Office has the case in appeals status. However, the Education Appeal Board does not have the case on its docket (either as an open or finalized appeal).

GAO Assessment: This case has been floating for four years. If payment was made to the program office, Finance is unaware of it and has not closed out the account. No action has been taken to pursue collection.

ED Response : We learned through our present review of this case that the program office has agreed in prior periods to allow a reduction to be made in the amount awarded to treat the case as an offset. To date, all necessary information has not been prepared by the ED program office to allow the case to be closed. Further action will be taken by the ED Finance Office to secure documentation which will allow the file to be closed.

CASE NO. 3

ACN 05-10403 Title I, Elementary and Secondary Education Act - Michigan State Department of Education

GAO COMMENT

Present Status: Case is open as of 10/23/81. Collection is anticipated but may be delayed.

GAO Assessment: Extensive delay was encountered in the appeals process (September 1974-February 1980). Once the appeal was settled, Education failed to aggressively pursue collection. The debt has been outstanding for over seven years; there has been adequate time for Michigan to enact legislation if necessary. Education should actively pursue collection efforts to include charging interest on the debt.

ED Response : In a letter dated July 15, 1980 to the former Assistant Secretary for Elementary and Secondary Education, there is an indication that the State satisfied the debt through the use of State school aid funds, and that satisfactory evidence was submitted to the Department to demonstrate that State funds had been expended in lieu of Federal funds. The Finance Office will contact the program office and the State in order to secure copies of the above mentioned documentation for the purpose of closing the file. Further, the Department is currently performing a full review of the audit follow-up process. This review will outline means by which the process can be expedited including the assignment of finance charges in cases under appeal.

CASE NO. 4

ACN 09-00002 Title I, Elementary and Secondary Education Act - California State Department of Education

GAO COMMENT

Present Status: Open, under appeal as of 11/30/81. Negotiations continue between the State and the Assistant Secretary for Elementary and Secondary Education to settle the case outside the appeal process.

GAO Assessment: Extensive delays have been encountered in the appeals process. The legality of the Education Appeal Board's regulations is of major concern to the settlement of this case. However, the case may be settled outside the appeals process. This large disallowed amount has been outstanding for over two years.

ED Response : It is important to note that while delays were experienced in the resolution process, the actual appeal procedure was followed in a timely manner. This case was suspended until May 16, 1982 by order of the Appeal Board Panel to allow all concerned parties to gather the information needed to move toward resolution.

CASE NO. 5

ACN 03-50002 Title I, Elementary and Secondary Education Act - State Department of Education, Pennsylvania

GAO COMMENT

Present Status: The Education Appeal Board is awaiting word from the Secretary of Education to allow the Board to go forward in the case (per order of 02/25/81). As of October 1981, no word has come from the Secretary.

GAO Assessment: As of October 1981, the case has been under appeal for over 4 and 1/2 years. Legal complications have contributed to the delays in settling the case. Education should actively pursue resolution of this matter to bring the seven year old case to a conclusion as soon as possible.

ED Response : As a result of the decision of the Third Circuit Court, the Secretary has issued written instructions that the Board indefinitely suspend this case.

CASE EXAMPLES SUBMITTED TO THE DEPARTMENT OF HEALTH AND HUMAN SERVICES

CASE NUMBER HHS-1

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Services Administration

Audit Report Number and Date: 07-93343 issued 01/09/79

Auditee: Yeatman Health Center, St. Louis, Missouri

Amount Questioned: $48,711

Amount Disallowed: $48,711

Date of Disallowance: 11/30/79

Recovery Action Taken: As of October 1981, the disallowance has not been recovered.

Appeal Status: No appeal filed.

CASE FACTS:

01/09/79 - Audit report issued showing excess expenditures which were not documented.

11/30/79 - Audit disallowance letter was issued for $48,711.

12/14/79 - A "pending" receivable was established by HSA finance office.

06/21/80 - An actual receivable was established by HSA finance office.

12/01/80 - HSA finance office sent a demand letter for $48,711. Letter stated interest would be charged at the rate of 3/4 of 1% per month on the unpaid balance, for each 30 day period (or portion thereof) beginning 30 days from the date of this letter.

01/27/81 - HSA finance office sent another demand letter showing an accumulation of interest due of $365. Total note due of $49,076.

04/13/81 - HSA finance sent another demand letter for $50,172.32 (includes interest of $365.33 per month or portion thereof from January 1, 1981).

05/28/81 - HSA finance office sent memo to HSA Grants Management Branch stating debt is over 90 days old and uncollectible.

CASE STATUS:

Outstanding and uncollected as of October 1981.

GAO ASSESSMENT:

The audit disallowance was not actively pursued from 11/30/79 to 12/01/80. Additionally, as of 10/26/81 the Grants Management Branch has taken no action on the case since it was referred to them on 05/28/81.

CASE NUMBER HHS-2

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Services Administration

Audit Report Number and Date: 06-93377 issued 09/20/79

Auditee: Flint-Goodrich Hospital, New Orleans, Louisiana

Amount Questioned: $44,357

Amount Disallowed: $21,600

Date of Disallowance: 04/28/80

Recovery Action Taken: $15,500 has been repaid through installment payments.

Appeal Status: No appeal filed.

CASE FACTS:

09/20/79 - Audit issued.

04/28/80 - $21,600 sustained as disallowance.

05/05/80 - Contractor requested and was authorized installment payments by HSA contracting office.

05/09/80 - Audit-related debt recorded for $21,600 as account receivable by HSA finance office.

06/06/80 - HSA contracting office agreed to monthly payments of $2,500 commencing June 30, 1980.

07/09/80 - HSA finance office sent demand letter for $21,600. The letter stated interest would be charged at 3/4 of 1% on the unpaid balance for each 30-day period or portion thereof beginning 30 days from the date of the letter.

07/21/80 - Installment payment of $2,500 received by contracting office.

09/02/80 - Another demand letter was sent by HSA finance office for $21,600. The letter stated interest would be charged at the rate of 1.23% on the unpaid balance for each 30-day period or portion thereof beginning 30 days from the date of the letter.

09/23/80 - Contractor informed HSA finance office that HSA contracting office agreed to installment payments and that $7,500 had been paid on the account.

10/07/80 - Payment of $5,000 received by contracting office.

11/17/80 - Another payment of $2,500 received by finance office.

06/30/81 - Demand letter sent by finance office for $11,600. Letter stated late charges will be imposed at the rate of 1.48% per month on the unpaid balance, for each 30 day period (or portion thereof) beginning 30 days from the date of this letter.

07/17/81 - Payment of $2,500 received by finance office.

07/31/81 - Payment of $3,000 received by finance office.

PRESENT STATUS:

Disallowance is partially collected ($15,500) and installment payments are overdue as of 10/26/81.

GAO ASSESSMENT

Decentralized collection of the receivable has delayed HSA's efforts to recover this audit disallowance. HSA's finance office was not aware of the contracting office's agreement to installment payments or payments made to HSA through the contracting office. Although contractor agreed to monthly installments of $2,500, this schedule has not been met. HSA finance office threatened to charge interest but has failed to do so. We re-reviewed the case file on 10/26/81 and found that the contractor was behind on payments. Finally, HSA did not seek documentation to support the grantee's inability to repay the debt in one lump sum.

CASE NUMBER HHS-3

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Care Financing Administration

Audit Report Number and Date: 09-70201 issued 04/27/77

Auditee: State of Hawaii, Department of Social Services and Housing

Amount Questioned: $69,945

Amount Disallowed: $69,945

Date of Disallowance: 12/21/78

Recovery Action Taken: No recovery as of July 1981.

Appeal Status: $12,258 appealed on 02/14/79. Appeals Board closed case on 12/02/80.

CASE FACTS:

04/27/77 - Audit report was issued.

12/21/78 - Disallowance letter for $69,945 sent to Hawaii.

02/14/79 - State appealed $12,258 to the Departmental Grant Appeals Board.

03/15/79 - Appeals Board notified the State that the State's appeal submission was incomplete and that unless the required information was sent within 30 days the case would be closed.

06/22/79 - State submitted the needed documentation.

08/07/79 - Appeals Board accepted State's appeal submission and notified HCFA to respond to the appeal within 30 days.

08/27/79 - HCFA requested an extension of time until 12/07/79 to respond to the appeal submission.

10/03/79 - Appeals Board granted the extension to 12/07/79.

12/11/79 - HCFA submitted its response.

12/02/80 - The Appeals Board closed its case because the parties agreed that the case involved only an accounting question regarding how the disallowance should be calculated.

12/04/80 - State requested dismissal of its appeal because it agreed with HCFA calculations.

PRESENT STATUS:

As of 07/81 the entire disallowance of $69,945 was uncollected.

GAO ASSESSMENT:

HCFA headquarters was not aware that the State had withdrawn its appeal and therefore had not pursued collection of the disallowance. We informed HCFA headquarters of the case status in 07/81. HCFA officials said that the State would offset the disallowance against claimed expenses in its quarterly expenditure report for the quarter ending 09/30/81. The grantee was able to hold $69,945 for at least 2 and 1/2 years interest-free.

CASE NUMBER HHS-4

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Care Financing Administration

Audit Report Number and Date: 02-70212 issued 2/28/77

Auditee: New Jersey State Department of Human Services

Amount Questioned: $4.2 million

Amount Disallowed: $4.2 million
$2.2 million (revised)

Date of Disallowance: 12/10/79
12/21/80 (revised)

Recovery Action Taken: No recovery as of July 1981.

Appeal Status: $4.2 million appealed 01/09/80. Under appeal as of July 1981.

CASE FACTS:

02/28/77 -	Audit report issued showing questioned costs for ineligible, nontherapeutic sterilizations under the Family Planning services of the Title XIX program.
12/10/79 -	Audit disallowance letter was issued to State for $4.2 million
01/09/80 -	State appealed to the HHS Departmental Grant Appeals Board.
02/21/80 -	HCFA requested an extension of time until 04/15/80 to respond to State's appeal because it needed to develop case information.
02/26/80 -	Extension was granted.
05/20/80 -	State requested 90 days to respond to HCFA's response to the State's appeal.
05/29/80 -	Extension was granted.
08/22/80 -	State requested extension to await HCFA's review of State figures.
09/22/80 - 12/02/80	Two extensions were granted to 12/21/80.
12/21/80 -	HCFA notified the Appeals Board that as a result of extensive negotiations, the disallowance was being reduced to $2.2 million.
01/14/81 -	HCFA requested opportunity to respond to State reply dated 12/22/80.

PRESENT STATUS:

Under appeal as of July 1981.

GAO ASSESSMENT:

The Appeals Board has granted numerous extensions to both parties. The result is that as of 07/81 the case is still outstanding. The Board has allowed the parties to continually discuss the case and to date has had minimal involvement in rendering any final decision. Our review of the appeal files showed that the last action on the case was the January 1981 correspondence. This case shows numerous extensions which have delayed any appeal decision.

CASE NUMBER HHS-5

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Care Financing Administration

Audit Report Number and Date: 05-30083 issued 02/05/73

Auditee: Wisconsin Department of Health and Social Services

Amount Questioned: $2.9 million

Amount Disallowed: $2.9 million
$2.1 million (revised)

Date of Disallowance: 04/02/73
02/15/79 (revised)

Recovery Action Taken: No recovery as of October 1981.

Appeal Status: $2.1 million was appealed on 05/17/73. HCFA and the State reached a final settlement on about 10/01/81.

CASE FACTS:

02/05/73 - Audit report was issued which questioned payments to ineligible patients and an ineligible medical facility.

04/02/73 - Audit disallowance letter issued to Wisconsin for $2.9 million.

05/17/73 - State requested that HCFA reconsider the audit report findings.

12/09/75 - HCFA responded to the State's reconsideration request. HCFA asked that the State submit any new evidence, documents or arguments it would care to submit.

02/12/76 - State said its appeal rested on original evidence and it did not care to submit new arguments.

04/08/76 - HCFA Regional Office resubmitted a copy of the original analysis.

02/15/79 - HCFA reduced disallowance to $2.1 million and notified the State.

03/14/79 - State appealed to Departmental Grant Appeals Board.

06/06/79 to 12/14/79 - State requested and Appeals Board granted four extentions for a total of 180 days.

12/21/79 to 04/04/80 - HCFA requested and Appeals Board granted two extensions for a total of 110 days.

10/01/81 - HCFA and the State notified the Board that they had reached a final settlement of the dispute and that the only matter not finally resolved was the final figure to be repaid. The parties did not anticipate any difficulties in arriving at the final figure.

PRESENT STATUS:

Uncollected; negotiations continue as of October 1981.

GAO ASSESSMENT:

HCFA's lack of attention early in the process (May 1973 to December 1975) delayed the case substantially. We believe that the Appeals Board should have attempted to render a decision earlier in the process and should not have allowed numerous extensions from June 1979 to April of 1980. This case shows that the Appeals Board decision process is untimely and needs to be improved.

DEPARTMENT OF HEALTH AND HUMAN SERVICES RESPONSE

THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

21 APR 1982

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APR 23 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

The Honorable Jack Brooks
Chairman
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed is our response to your letter of February 24, 1982 requesting comment on the General Accounting Office Report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits." It answers the four questions for the record and covers the status of the specific audit reports cited in the GAO report (see Enclosure 1).

You also asked that we speak to any deficiencies found by the GAO in our procedures and practices and to any actions that we are taking to comply with Federal collection regulations and OMB guidelines.

In general, we have taken two major actions to improve the area of audit resolution. Largely out of a commitment to you in testimony by officials of this Department, we have developed a comprehensive audit resolution policy which implements OMB Circular A-73 and gives clear direction for resolving audit findings on contract and grant programs from the issuance of an audit report to final resolution. A copy of the policy is also enclosed for your information (Enclosure 2).

I wish to point out that this audit resolution policy circular is presently undergoing revisions which address, principally, additional emphasis on audit resolution, as well as related organizational changes made during the past year, and a copy of it will be sent to the Committee when it is issued.

We have also implemented monitoring procedures to assure that audit reports involving questioned costs are resolved within six months after their issuance. The monitoring is accomplished through a monthly reporting system. Problems identified through the system are brought to an expeditious settlement by a high-level Audit Resolution Council headed by the Under Secretary. To date this system has been very successful.

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Legislation and National
Security Subcommittee

In response to the requirements of P.L. 96-304, which required that all audit reports with monetary findings over six months old be resolved by September 30, 1981, we reinstituted the Audit Resolution Council mentioned above. During the period July 1 through September 30, the Department obtained resolution of 752 (of 756) such audit reports, which contained questioned costs totalling approximately $180 million. Three of the four unresolved audits were placed on hold by a grand jury investigation, and the fourth was resolved in December (the total amount of these four audits was less than $200,000). Since September 30, the Department has continued to resolve virtually all audits which would have become six months old, in accordance with the law and our current procedures.

Nevertheless, as a result of your letter and the GAO report, we have discovered a specific problem in the Health Services Administration (HSA) of the Public Health Service concerning uncollected audit disallowances. Our review of the Yeatman and Flint-Goodrich cases (discussed in further detail in Enclosure 1) has led us to recognize the need to improve audit related collection procedures within HSA. Therefore the Public Health Service has committed itself to take the following actions at HSA:

-- a complete review of all existing audit disallowance documents will be conducted and appropriate collection steps taken;

-- a control for each document will be established to reflect actions taken to date, thereby insuring that all collection steps are taken promptly;

-- further follow-up reviews will be made on a monthly basis to insure that subsequent cases are handled properly; and

-- an improved procedure is being initiated between the HSA Finance Office and the offices to which it provides support to insure timely notification to the finance office of the status of each audit disallowance case, and in turn to allow prompt billing to debtors.

The enclosures provide the additional specifics you requested. If I can assist you further, please let me know.

Sincerely,

Richard S. Schweiker
Secretary

Enclosures

(Subcommittee note.--Grants Administration Manual retained in subcommittee files.)

SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY'S QUESTIONS FOR THE DEPARTMENT OF HEALTH AND HUMAN SERVICES IN CONNECTION WITH SUBCOMMITTEE HEARING OF FEBRUARY 24. 1982 - FEDERAL DEPARTMENTS AND AGENCIES FAILURE TO COLLECT AUDIT-RELATED DEBTS

Question 1:

At what point in the audit resolution process does the Department of Health and Human Services sustain a questioned cost as an audit disallowance and establish a claim? What conditions must be met?

Response:

(a) A cost that was questioned during an audit is sustained as an audit disallowance when the designated action official establishes that the finding is correct and legally defensable. At that point, a determination letter is issued to the audited organization notifying it of the disallowance and setting forth its appeal rights. Concurrently, the deciding official prepares an audit clearance document (ACD) and forwards it to the Audit Agency and the Finance Office. The ACD is used by the Finance Office as the basis for setting up a receivable against the organization and instituting collection action.

(b) Disallowances are made based on the fact of whether an organization expended Federal funds for a purpose not authorized in the award document. The Department has established a policy, i.e.. Grants Administration Manual Chapter 1-105 which establishes controls to assure that audit findings are not indiscriminately set-aside by deciding officials. This policy provides for the approval of audit settlement by various supervisory levels dependent upon the dollar value of the findings and the extent to which the findings are upheld by the deciding official. A copy of this policy is attached for your information.

Question 2:

How does the Department assure itself that the funds it receives in payment of audit disallowances are not Federal funds or do not reduce the intended benefits of HHS programs?

Response

There is no absolute assurance that an audited organization will not pay back disallowed charges using Federal monies which it has received under other awards. We believe this could happen for short periods of time. But the possibility of an organization substituting Federal funds over long periods of time i.e., a year, is remote. HHS grantees are required to submit periodic expenditure and program performance reports and an audited organization cannot reduce the scope of intended benefits of HHS programs and still remain in compliance with the conditions of its awards. Additionally, the Department attempts to reduce the risk of the improper use of Federal funds by setting an organization's cash draw down authority at a level commensurate with its current cash needs to perform its active awards.

Question 3:

Since 1979, the Federal Claims Collection Standards have required the charging of interest on all delinquent debts. Why has the Department not been assessing interest on delinquent audit-related debts? When will this requirement be fully implemented?

Response

The Department's Audit Resolution Policy (GAM Chapter 1-105) originally issued July 31, 1980, stipulates that interest will be assessed on delinquent audit related debts. Each of the Department's operating divisions have informed us that the policy is being implemented, or is inapplicable because of the amount of the debt is immediately deducted from an agency's grant authority and available funds. The one exception is the programs administered by the Social Security Administration. SSA is reviewing its ability to charge interest as part of a larger study regarding the assessment of interest to all non-beneficiary monetary transactions. SSA expects its review to be completed by the end of this month.

Question 4:

What is HHS's position on holding grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee?

Response:

The general principle, which is set forth Government-wide by OMB Circulars A-102 and A-110, is that the grantee is responsible for the settlement and satisfaction of disputes arising out of subgrants. The Department has no privity with sub-grantees and hence looks to the grantee for the full accountability of funds awarded to it.

The Department assumes no responsibility for the debts of either a grantee or its sub-grantees.

Additional Response:

The status of the five audit cases summarized in Chairman Brooks' request is as follows:

05-30083 — Wisconsin Department of Health and Social Services

This audit has been fully resolved. A Notice of Settlement was signed on October 1, 1981, by attorneys for both the Health Care Financing Administration (HCFA) and the State of Wisconsin.

Federal funds in the agreed-to amount of $277,239 were recovered on Wisconsin's Quarterly Expenditure Report of December 31, 1981.

02-70212 — New Jersey Department of Human Services

On March 5, 1982, the Department's Grant Appeals Board issued a decision in this audit appeal. The Board upheld HCFA's disallowance of funds for the period April 1974 through September 1975; and overturned HCFA's disallowance of funds for the period September 1975 through December 1975. As soon as the disallowed funds are broken out into these two periods, expenditure reports will be adjusted.

09-70201 — Hawaii Department of Social Services and Housing

The audit has been fully resolved. The disallowed amount ($69,945) recovered was on Hawaii's Quarterly Expenditure Report of June 30, 1981.

07-93343 — Yeatman Health Center and 06-93377 — Flint-Goodrich Hospital

These two audit cases remain uncollected at this time. On March 15, final demand letters were sent requesting payment of principal and late charges. Flint-Goodrich Hospital requested and was granted an extension of time until April 30 in which to liquidate its debt to HHS. If no payment is received by April 30 this case will be sent to the Claims Officer for further action, which may include submission to the Justice Department. We are also exploring the practicability of offsetting this amount against Maternal and Child Health funding to Flint-Goodrich.

In the Yeatman case although PHS had written to Yeatman about the audit disallowance and had demanded payment on three other occasions, Yeatman has informed us that it had not received notice of such audit disallowance. Consequently, Yeatman has requested an appeal of the audit determination. Therefore, collection of the Government claim will be held in abeyance pending disposition of the appeal.

Because of the unsatisfactory manner in which these cases have been handled, the Public Health Service has committed itself to exercising stringent oversight of the agency which is responsible for these awards (see covering letter).

CASE EXAMPLES SUBMITTED TO THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

CASE NUMBER HUD-1

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Indian Programs

Audit Report Number and Date: CDBG B-77-DN-06-0445 issued 01/29/79

Auditee: Elem Indian Colony of Pomo Indians

Amount Questioned: $137,012

Amount Disallowed: $137,012

Date of Disallowance: 04/22/80

Recovery Action Taken: Unrecovered as of 06/30/81.

Appeal Status: No appeal filed.

CASE FACTS:

01/29/79 -	Audit issued with questioned costs of $137,012 for lack of documentation to support costs.
04/22/80 -	Costs declared ineligible since grantee had not responded to any HUD inquiries. Funding approval on a new grant for $22,500 was revoked.
01/29/79 - to 04/22/80	HUD Office of Indian Programs made various attempts to get grantee to respond to questioned costs with no success.
09/26/80 -	Program officials refer claim for $137,012 to the program Claims Collection Officer.
01/13/81 -	Program Office administratively closes case.

PRESENT STATUS:

Unrecovered, pending with Office of Indian Programs' Claims Collection Officer.

GAO ASSESSMENT:

HUD tried to get the grantee to respond but should have disallowed the costs before waiting 15 months. The claim should have been established as an account receivable and should have been referred to the Department Claims Collection Officer. The claim should not have been closed out prior to recovery or write-off.

CASE NUMBER HUD-2

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Community Development Block Grant

Audit Report Number and Date: CDBG B-75, 76, and 77 MC-06-0008 as of April 30, 1978
issued 08/14/78

Auditee: City of Berkeley, California

Amount Questioned: $2.3 million

Amount Disallowed: $87,482

Date of Disallowance: 05/01/81

Recovery Action Taken: No recovery as of June 30, 1981.

Appeal Status: No appeal filed.

CASE FACTS:

08/14/78 - Audit report issued with questioned costs of $2.3 million, of which $2.2 million related to charges not based on an indirect cost allocation plan.

08/31/78 - Grantee notified of audit findings.

11/24/78 - HUD program staff concurr with the Office of Inspector General (OIG) and stated the grantee was developing a cost allocation plan.

01/31/79 - OIG closed audit and put into post audit verification for follow-up to see that plan is developed.

04/30/81 - HUD notified grantee that all but $87,482 is allowed.

05/01/81 - HUD sustained disallowance of $87,482.

PRESENT STATUS:

As of 6/30/81 the sustained disallowance had not been collected and HUD had not established an account receivable.

GAO ASSESSMENT:

It took almost 3 years to make a determination on the allowability of $87,482 in questioned costs. During this time the grantee had use of these funds interest-free. HUD should have taken more aggressive action to resolve the questioned costs and once disallowed, a receivable should have been established in the accounting records.

CASE NUMBER HUD-3

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Indian Programs

Program: Assisted Housing

Audit Report Numbers and Date: Assisted Acc Numbers SF-496, 673, 655
Plc numbers SF-288, 289, 209 issued 07/11/80

Auditee: Owens Valley Housing Authority, Big Pine, California

Amount Questioned: $29,234

Amount Disallowed: $29,234

Date of Disallowance: 11/10/80

Recovery Action Taken: None - forgiven 12/30/80

Appeal Status: No appeal filled.

CASE FACTS

07/11/80 - Audit report issued with disallowed costs of $11,234 for ineligible expenses and $18,000 questioned costs for unrecorded bank account activity.

11/10/80 - $29,234 disallowance sustained.

12/11/80 - Office of Indian Programs (OIP) closed finding for $11,234 (relating to ineligible expenditures) although no recovery made by HUD.

12/30/80 - OIP administratively closes finding for $18,000, although no recovery made by HUD.

12/30/80 - The Office of Inspector General (OIG) concurred with OIP and closed audit.

12/30/80 - OIG audit findings control log shows two disallowances, for $18,000 and $11,234, sustained findings as "forgiven". There is no indication that these findings were ever referred to a claims collection officer at HUD. Claim was not referred to HUD headquarters or GAO for collection prior to being forgiven.

PRESENT STATUS:

Closed, no recovery, forgiven.

GAO ASSESSMENT:

HUD had no concrete reason to administratively close this case prior to collection. HUD did not set up a receivable in its accounting records. OIP did not clear dismissal of this case through HUD headquarters or GAO as required by HUD regulations and the Claims Collection Standards.

CASE NUMBER HUD-4

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Community Development Block Grant Program

Audit Report Number and Date: CDBG B-76/77/78-UC-06-0005 at 06/30/79, issued 08/20/80

Auditee: County of Sacramento, California

Amount Questioned: $299,801 .

Amount Disallowed: $22,495

Date of Disallowance: 02/13/81

Recovery Action Taken: No recovery as of 06/30/81.

Appeal Status: No appeal filed.

CASE FACTS:

08/20/80 - Audit report issued with questioned costs of $229,801 relating to ineligible expenses of a county subgrantee, St. Marks Housing Rehabilitation Group.

02/13/81 - Letter from HUD notified grantee that $22,495 was disallowed and county should reimburse CDBG program account within 15 days after receipt of letter.

02/26/81 - County letter to HUD requested 6-week extension on repaying $22,495 disallowance because the Board of Supervisors referred the matter to the Sacramento County Grand Jury for their independent review. The county turned the case over to the Grand Jury because they believed there was potential fraud.

03/05/81 - HUD approved 6-week extension to repay $22,495.

04/07/81 - HUD Office of Inspector General closed the audit, prior to any recovery.

06/15/81 - HUD internal communication stated if county does not repay $22,495 within 90 days HUD will reduce the FY 1981 grant by that amount.

06/16/81 - HUD notified grantee that since St. Marks was its subgrantee, the county is responsible for those funds and the 1981 CDBG entitlement of $5,318,000 could be reduced if repayment is not made.

PRESENT STATUS:

As of 06/30/81, the disallowance of $22,495 had not been recoverd, and an account receivable had not been established. County officials told us they intend to opt for offset rather than paying HUD from general revenues.

GAO ASSESSMENT:

HUD should have set this case up as an account receivable and charged interest. HUD OIG should not have closed this case prior to an actual recovery. The practice of repaying subgrantee debt by reduction of the next year's grant should be carefully monitored to assure no reduction in grant performance. Otherwise, the actual source of the disallowance, the subgrantee, ends up not being held accountable, and the CDBG program may be diminished.

CASE NUMBER HUD-5

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Community Development Block Grant and Model Cities Programs

Auditees: Subgrantees of the City of Los Angeles

The City of Los Angeles audits or contracts for audits of its subgrantees every 2 years and disallows questioned costs that cannot be documented by the subgrantees. The city does not notify HUD of any sustained disallowed costs established by city audits of subgrantees, but leaves it up to HUD to find these disallowances when it does its audit of the city's administration of the program.

City officials have taken a firm stand that they have no obligation to repay HUD for subgrantee disallowances until the city has recovered from the subgrantee or all possible legal actions have been taken against the subgrantee. Their position is that the city is not responsible for the action of its subgrantees. The city has refused to repay subgrantee audit disallowances from general revenues.

We evaluated six subgrantee audits with disallowed costs established by the City of Los Angeles. No collections had been made by the city nor had any funds been returned to HUD as of July 1981.

The table below summarizes these audits and shows when HUD questioned these costs in its audits.

Subgrantee Auditee	Date of City Audit	Amount of Disallowance	Date of Disallowance	Date HUD Questioned Costs
Community Concern	10/25/73	a/$ 15,327	07/18/74	07/10/80
Yellow Cab Co. Dial-A-Ride	07/20/78	9,612	Not given	06/30/80
Greater Watts Economic Development Corp.	Not given	54,678	04/08/74	07/10/80
Narcotics Prevention Project	07/28/78	86,220	07/28/78	06/30/80
East Los Angeles Improvement Assoc.	05/31/78	b/ 105,803	06/29/78	06/30/80
	06/12/79	229,536	09/18/79	06/30/80

a/ HUD questioned $15,327, while the city originally disallowed $15,625.

b/ City disallowed costs of $105,811 while HUD shows $105,803.

The total amount of these audits comes to $501,266 of disallowed costs not collected or returned to HUD.

The following gives a description of each of these six subgrantee audits as of July 1981:

Community Concern Corporation

$15,626 was disallowed 07/18/74 by the city. It was later reduced to $15,327. The organization went out of business in 1974; no assets were available to repay the debt. Nothing has yet been collected. The disallowance was referred to the City Attorney, no suit has been filed yet, and the statute of limitations may run out. HUD questioned this audit in Model Cities report of 07/10/80 and recommended it be removed from eligible program expenses.

Yellow Cab Company of California, Beverly - Fairfax Dial-A-Ride

City audit of 07/20/78 questioned $9,612 of expenses which were disallowed that same year. However, the parent corporation has gone bankrupt and no funds have been recovered. City Attorney has the case, but no suit has yet been filed. HUD questioned in Block Grant audit of 06/30/80 and the Office of Inspector General recommended the city repay HUD.

Greater Watts Economic Development Corporation

$54,768 was disallowed by city 04/08/74. Corporation was defunded from the program 04/30/74 and has been non-existent since that time. City Attorney filed a suit alleging $54,768 damages 04/07/78, but the defendent was not yet served. This case may be criminal in nature. HUD questioned in Model Cities audit of 07/10/80 requesting city to reimburse program for these expenses.

Narcotics Prevention Project (NPP)

Originally on 07/28/78, $180,675 was disallowed. This was changed several times and the disallowed costs now stand at $86,220. NPP was granted $460,000 of CDBG funds to rehabilitate drug addicts. $180,675 of these funds were used to pay for detoxification treatment at a hospital which had a subcontract to provide these services. The administrator of the hospital was convicted by a Federal court of depositing $150,000 of checks payable to the hospital into his own account. An additional $30,195 was paid by NPP to another hospital not licensed by the State. The disallowance against NPP was reduced to $86,220 based on the fact that services were provided to the drug addicts. To date no payments by NPP have been made. The case is with the City Attorney and no suit has yet been filed. The statute of limitations may run out soon. HUD requested reimbursement from the city in OIG CDBG audit of 06/30/80.

East Los Angeles Improvement Association

In the first audit of this subgrantee the city disallowed $105,811 on 06/29/78. The contractual relationship with the city was terminated 06/30/78. The subgrantee did not respond to the audit report. The case was turned over to the City Attorney to institute legal action but no suit has yet been filed and the statute of limitations may run out soon. HUD questioned these costs in CDBG audit of 06/30/80 and recommended the city reimburse the program.

East Los Angeles Improvement Association

The city disallowed $229,536 of this subgrantee's expenses on 09/18/79. The sybgrantee had previously been defunded and dropped from the program as of 06/30/78. The subgrantee failed to respond to the audit. Although documentation states case was to be turned over to the City Attorney, there is no indication that it yet has been. The city has requested the FBI to continue its investigation of the subgrantee as to possible misappropriations of Federal funds to determine whether there is any criminal involvement. The city filed suit for a total of $336,374 on 12/12/79 which includes the previous amount of $105,811. HUD questioned this second amount ($229,536) in its CDBG audit of 06/30/80 and requested that the city reimburse the program for this amount.

PRESENT STATUS:

As of July 1981, four of the five subgrantees were out of business or receiving no funds from the city, while the city had made no collection and returned no funds to HUD. HUD auditors reviewed these disallowances in June and July 1980 and recommended that the city repay HUD. But as of July 1981, HUD had taken no action to recover the funds.

GAO ASSESSMENT:

In spite of the city's claim that it cannot be held accountable for debts until it recovers disallowed costs from subgrantees, HUD has no choice but to hold the city accountable and take aggressive collection action. If the city is not held accountable, it will have no incentive to ensure the propriety, legality and correctness of subgrantees' use of Federal funds.

CASE NUMBER HUD-6

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Community Development Block Grant

Audit Report Numbers and Dates: CDBG B-75/76/77/78-MC-06-0016, B-75-DS-06-9029, B-77-DS-06-9030, and B77-UR-06-003 as of 01/31/79, issued 08/23/79

Auditee: City and County of San Francisco

Amount Questioned: $98,561 ($25,880 relates to subgrantee)

Amount Disallowed: $26,017 ($25,880 relates to subgrantee)

Date of Disallowance: 11/07/79

Recovery Action Taken: On 06/03/80 City reduced its letter of credit by $25,880 to cover subgrantee disallowance.

Appeal Status: No appeal filed.

CASE FACTS:

08/23/79 - Audit of the grantee was released with costs of $98,561 questioned by the auditors. Of this total, $25,880 related to a subgrantee, Ambulatory Health Care Facility, for payroll costs duplicated by the city's department of social services and retained by the subgrantee to set up a working capital fund.

11/07/79 - City responded to HUD that it had requested the subgrantee to return $25,880 immediately. This was confirmed by letter from the city to the subgrantee dated October 16, 1979.

01/28/80 - Subgrantee notified the city it intended to repay $8,500 in cash and the remainder when it collected from the State under another program.

02/29/80 - City notified HUD that an $8,500 portion of the questioned $25,880 had been repaid to the city and the balance would be returned when the subgrantee received funds under a State program.

04/17/80 - HUD Inspector General closed the audit findings on the basis that the city would reimburse the remaining $17,380 related to its subgrantee.

06/03/80 - City deducted $25,880 disallowance from its request for payment from HUD on the letter of credit.

12/03/80 - City demanded that remaining $17,380 owed by AHCF be repaid by 12/15/80.

12/15/80 - AHCF notified city that repayment of $17,380 is impossible because it had no other source of funds.

07/01/81 - The city still had not been able to recover the remaining $17,380 from the subgrantee, so the city's block grant program was short that amount.

The city has threatened to stop funding the subgrantee but AHCF has continued to be funded. In 1981 AHCF was budgeted for $201,670 and the city had not reduced payments to recover the $17,380 owed.

PRESENT STATUS:

Case closed; HUD has recovered from the grantee, city had not recovered from the subgrantee as of July 1981.

GAO ASSESSMENT:

The Community Development Block Grant program suffers because the city has not recovered the disallowance from the subgrantee. The source of the disallowance is not being held accountable and other intended recipients are cut short as a result. HUD has unknowingly recovered the disallowance at the expense of program objectives.

CASE NUMBER HUD-7

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Community Development Block Grant

Audit Report Numbers and Dates: CDBG B-75 through 78- MC-06-0013 as of June 30, 1979, issued 11/20/80 and CDBG6 B76/77 MC-06-0013, issued 02/04/80. Grantee audit of OBHI issued 09/30/80.

Auditee: City of Oakland, California (grantee); Oakland Better Housing, Inc. (OBHI) (subgrantee)

Amount Questioned: $52,823

Amount Disallowed: $27,250

Date of Disallowance: HUD disallowed a total of $27,250 of grantee funds relating to subgrantee expenses on 06/19/80 and 11/20/80.

Recovery Action Taken: Grantee repaid HUD $25,666 on 09/29/80 and $1,584 on 07/01/81 (for subgrantee repaying grantee, see below).

Appeal Status: No appeal filed.

CASE FACTS:

09/30/80 - City of Oakland released the audit of its subgrantee Oakland Better Housing, Inc. (OBHI). HUD required the City of Oakland to conduct a management and fiscal audit of the city's subgrantees including OBHI's prior 5 years of operation.

02/04/80 to 11/20/80 HUD issued audits of the City of Oakland. Both HUD and the City of Oakland sustained total disallowances of $27,250 relating to the questioned costs at OBHI.

09/29/80 - The City of Oakland paid $25,666 of the debt to HUD by reprogramming the ineligible expenses to other block grant expenses that were eligible.

10/31/80 - Oakland paid OHBI $12,484 under the Department of Labor CETA program. OBHI then endorsed this check back to the City of Oakland to repay the HUD disallowed costs. OBHI still owed the city $6,652. OBHI expected to repay this with another CETA check due them from the city.

06/23/81 - An Oakland city official stated he does not care where the subgrantee gets the funds to repay, as long as they are not from the HUD CDBG account. This official admitted that since OBHI had not yet been audited by CETA, Labor might not accept its funds being used to repay a HUD debt.

07/01/81 - The City of Oakland paid the remaining $1,584 to HUD.

07/07/81 - The Executive Director of OBHI said this type of interfund transfer is common and he sees no problem with doing it.

HUD officials acknowledged they do not assure themselves that non-Federal funds are used to repay audit-related debts.

PRESENT STATUS:

According to HUD records, the audit is "closed, recovered." Grantee is still owed $6,652 by OBHI as of 07/01/81.

GAO ASSESSMENT:

Subgrantee repaid a portion of the audit-related debt to grantee using other Federal funds. This would hurt the objectives of Labor's CETA program. HUD should require that all audit disallowances be paid with non-Federal funds.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT RESPONSES

THE UNDER SECRETARY OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

March 31, 1982

RECEIVED
MAR 31 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman, Subcommittee on Legislation
and National Security
Committee on Government Operations
House of Representatives
Washington, DC 20515

Dear Mr. Brooks:

Secretary Pierce has asked me to respond to your letter of February 24, 1982, concerning the General Accounting Office (GAO) report entitled, "Federal Agencies Negligent in Collecting Debts Arising From Audits," which included six examples of apparent HUD deficiencies in collecting audit-related debts. Your letter also enclosed some questions which you asked us to address.

Prior to issuance of the GAO report, the Department had itself been aware that changes were needed in the audit resolution and debt collection systems and had already taken steps for improvement. For instance, certain changes had been instituted on tightening time requirements for making determinations on external audit findings; on intradepartmental reporting of debt collection activity; and on procedures for controlling the collection of audit-related debts.

As GAO concluded, however, the implementation of established procedures may not in all cases have been both thorough and timely. It would appear that four of the examples appearing in the report--those on Pages 7, 14, 15 and 27--were not handled as aggressively as they should have been. Regarding the fifth example, cited on Page 27 of the report, HUD disallowed $22,495 and reduced the following year's grant by the disallowed amount. Grant reduction is the basic sanction against Community Development Block Grant (CDBG) Program recipients. While this action reduces benefits to the grantee, it does not reduce overall benefits of the program because the funds are reallocated to other grantees in the same area or within the State. This is explained further in response to Question 2. The reason for the sixth example is as stated by GAO in their report. We do not believe it is practical for HUD employees to trace every transaction between a grantee and its subgrantees to assure that repayment was not made from other Federal funds. We also address this again in response to Question 2.

HUD is in the process of issuing additional procedures on audit resolution and related debt collection which will bring us into full compliance with Federal claims collection regulations and the Office of Management and Budget (OMB) guidelines. Our audit follow-up system is described in HUD Handbook 2000.6, Audits Management System (AMS). This Handbook has been revised to comply with existing OMB guidelines and the Supplemental Appropriations and Rescission Act of 1980. It is in the final clearance stage and is scheduled for issuance in April 1982. The new procedure requires resolution of audit findings within 120 days. If audit findings are not resolved, they are referred to Headquarters for resolution, with a determination required within 2 months in order to meet OMB's 6-month time frame for resolution. Even though the Handbook is still in clearance, the procedures which require resolution within 6 months have already been implemented.

In addition, HUD's Office of Finance and Accounting has developed a draft Notice, entitled, "Financial Control Requirements for Sustained Costs Resulting From Inspector General Audit Findings," scheduled for issuance in April. This Notice contains procedures for recording, collecting, and aging disallowed audit costs, as well as instructions for assessing interest.

Answers to your specific questions will be found in Enclosures 1-6. Several general comments are, however, in order concerning "debts arising from audits." First, audit findings at HUD that reflect disallowed costs do not necessarily result in a debt owed to HUD or the Federal Government. In many cases, because of the nature of the statutory and regulatory structure of the programs involved, the disallowed costs are owed to the HUD-insured or -funded project, to the program account, or even to program beneficiaries, rather than directly to HUD or the Federal Government. Thus, it is not appropriate to set up accounts receivable in favor of the Government until there has been a determination as to whether the audit disallowances are due and owing to HUD or to a program participant. Secondly, in the CDBG Program, legislation permits reduction in future grant amounts as a means to settle audit disallowances.

You also enclosed with your letter seven "specific examples of collection problems GAO found in [HUD]." The status of those cases is contained in Enclosures 7-13.

We believe that HUD has made substantial progress in the audit resolution and related debt collection process. We will continue to strive for improvements. Should your staff need any further information, please have them contact David Karnes, my Special Assistant, at 755-7123.

Very sincerely yours,

Donald I. Hovde

Enclosures

ENCLOSURE 1

Question 1

At what point does HUD sustain a questioned cost as a disallowance and establish a claim? What conditions must be met?

Response

A questioned cost is sustained when a written determination is prepared by the appropriate program official specifying the amounts to be disallowed and concurrence on the determination is obtained from the Office of Inspector General (OIG). If the disallowed amounts are due to HUD, a claim is established. Our procedures require that the determination be made by our Field Offices within 120 days after the issuance of the audit report. If the determination is not made within 120 days, it is referred to Headquarters for resolution within 60 days. Therefore, the maximum time allowed to reach a determination is 6 months. Generally, sustained amounts involve expenditures that are in violation of existing statutes, HUD regulations or the terms of the contract or grant.

Question 2

How does the Department assure itself that the funds it receives in payment of audit disallowances are not Federal funds or do not reduce the intended benefits of HUD programs?

Response

HUD has no procedure to assure itself that funds received in payment of audit disallowances are not Federal funds from another agency. When an audit is conducted for a HUD-funded program, the auditor tests financial transactions to assure that expenditures are eligible costs. If the auditor finds that HUD funds are being used improperly to pay audit-related debts of other Federal agencies, the costs are disallowed. Likewise, other agencies' audit procedures should require the same verifications. GAO recognized this in its description of the case (Case Number HUD-7) where it found CETA funds were used to pay a HUD-related debt. GAO related that the CETA funds had not been audited and that the Department of Labor should not accept CETA funds being used to pay a HUD debt. We believe the current audit approach is sufficient to provide safeguards against Federal funds being used to pay debts to other agencies. We do not believe that HUD employees or auditors should be required to trace the source of payments as this would necessitate a 100 percent examination of all transactions. Such a review would be very difficult and time consuming.

Since 1975, the Office of Community Planning and Development has used a variety of alternatives to resolve audit disallowances in the CDBG Program. The underlying statutory sanction is the authority to reduce future entitlement grants. Generally, this sanction is only used if the grantee does not: (a) repay by reimbursing its letter-of-credit from local or other sources; (b) reprogram funds from other activities; or (c) increase its local support of eligible community development activity in an amount equal to the disallowance.

CDBG regulations further require that HUD add back to the State program balances or to the entitlement fund balances (within the same Standard Metropolitan Statistical Area) any amount recovered by audit resolution. Therefore, the overall intended benefits of HUD programs are not decreased.

ENCLOSURE 3

Question 3

Since 1979, the Federal Claims Collection Standards have required the charging of interest on all delinquent debts. Why has the Department not been assessing interest on delinquent audit-related debts? When will this requirement be fully implemented?

Response

Interest was not being assessed on audit-related debts because it was not clear to the accounting office that assessment of interest was applicable to such debts under the provisions of the Department's regulations or the Federal Claims Collection Standards.

Notwithstanding, the Department's Claims Collection Handbook, HUD-1900.25, was revised in August 1979 to provide that an interest charge will be added for all debts if money due is not repaid within a reasonable time, unless precluded by statute.

There was still some uncertainty regarding the requirement to charge interest on delinquent debt, and the Department's General Counsel was asked to provide an opinion. The opinion, issued on June 10, 1980, states that the charging of interest, as provided in the above referenced Handbook, is proper. Accordingly, a memorandum was issued on June 26, 1980, to all Regional Accounting Divisions (RADs) advising that interest should be charged on any delinquent debt unless there is a specific exemption. There were still no instructions as to the interest rate to be charged or the types of debt to be covered.

With the publication of Chapter 8000, Part 6 of the Treasury Fiscal Requirements Manual, specific information finally became available and, on September 10, 1981, instructions were issued to all Headquarters and Regional accounting offices requiring interest to be charged on all delinquent receivables (including sustained audit findings) at the rate prescribed by the Treasury Department. The instructions included a provision indicating that where the charging of interest is prohibited by statute, contract or regulation, or a different rate is mandated, interest at the rate specified in the Treasury Manual would not be assessed.

A Notice presently being cleared for issuance in April 1982, will provide Departmentwide procedures for all offices involved in the full range of actions for audit-related debts. The Notice will include a provision for assessment of interest on such debts, if they are not paid within a prescribed time. In addition, another issuance is being prepared to provide guidance for the proper handling of all debts owed to the Department. This issuance will also require the appropriate assessment of interest on delinquent debts.

We anticipate that with the actions already taken and with the steps now being undertaken, the Department will then be in full compliance with the Federal Claims Collection Standards.

Question 4

What is HUD's position on holding grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee?

Response

HUD adheres to the general principle that grantees are responsible for debts of subgrantees. (For this purpose, a subgrantee is any party receiving grant funds through the grantee.)

Question 5

HUD replied to GAO's questionnaire concerning the recovery of disallowed costs that accounts receivable are established for audit disallowances. GAO's work in one of HUD's Regions, however, showed that receivables are not established. What is the actual practice in your other Regions and when will accounts receivable be established for these debts universally?

Response

Notice 80-29, dated September 17, 1980, and a subsequent memorandum, dated January 13, 1981, prescribed instructions for accounting for sustained audit costs. In accordance with these instructions, the Regional Accounting Divisions (RADs) are to record receivables for sustained disallowed costs upon receipt of a copy of the Sustained Audit Finding Control Log with supporting audit finding concurrences. As of February 28, 1982, all RADs have reported audit-related receivables. Seven RADs, however, have not been recording these receivables in separate accounts that identify the specific program area. Appropriate instructions have been issued to the RADs to maintain accounts in a manner that identifies audit-related receivables by program.

In addition, a new Notice which is scheduled for printing in April 1982, will enhance the current procedures for recording, collecting, and aging disallowed audit costs, as well as instructions for assessing interest. The Notice will clarify the role of each office responsible for processing and controlling audit-related debts.

Also, a memorandum is being developed by the Assistant Secretaries for Housing, Administration, and Community Planning and Development that will instruct program officials in Headquarters and Field Offices to forward documents necessary for recording and reporting audit-related transactions to proper accounting offices. This will also delineate responsibilities for aggressive collection action.

The performance of each accounting office in recording these debts will be monitored to determine compliance with prescribed procedures.

Question 6

Most agencies have appeal systems which handle numerous audit disallowance appeals, yet HUD has none. How are differences over audit disallowances handled when auditees disagree with HUD?

Response

Auditees are furnished several opportunities to express their views and provide additional information in the audit resolution process. This process is established in our Audits Management System Handbook.

At the audit exit conference, auditees can tell the auditors directly that they disagree with the findings or provide additional information to clarify an issue. Their disagreement(s) or clarification(s) would then be incorporated in the audit report. Once the report is issued to program officials, the auditee is given another chance to express his/her views and provide further information. The program official analyzes the auditee's comments and information in relation to the finding. If the program official agrees with the auditee, the finding can be resolved in favor of the auditee. In this case, if the OIG disagrees with the auditee and the program officials, the matter is raised to higher levels of management in Headquarters. If the finding cannot be resolved between the program official and the OIG at this level, it is referred to the Field Audits Review Group and the Under Secretary for final determination.

In the event HUD sustains the questioned costs and the auditee disagrees, there is no formal appeal system for most HUD programs. However, if the auditee supplies additional information on the allowability of costs, program officials may reverse the sustained costs.

CASE NUMBER HUD -1

Auditee: Elem Indian Colony of Pomo Indians

Current Status

At the time of receipt of the report on audit (January 29, 1979), the Office of Indian Programs (OIP) realized that given the extremely limited Tribal financial resources, it would be difficult, if not impossible, for the Tribe to repay HUD for disallowed costs. They endeavored to work with the Tribe over the next 15 months to obtain the necessary documentation to support the questioned costs as eligible costs. The Tribe was completely uncooperative. All attempts were in vain. On April 22, 1980, OIP declared the costs disallowed and asked for repayment. Subsequently, the matter was referred to the Claims Collection Officer.

Given the facts that the Tribe does not have financial resources to repay or reprogram the disallowed amount, OIP sees no possibility of closing the subject finding by repayment/reprograming and is prepared to recommend that it be written off. In the meantime, similar situations should be minimized by increased technical assistance and closer monitoring of Tribal grantees by OIP.

ENCLOSURE 8

CASE NUMBER HUD-2

Auditee: City of Berkeley, California

Current Status

The questioned costs consisted of charges against the CDBG Program for 11 City departments. The audit report questioned all indirect costs because the City did not have an indirect cost allocation plan. Once an indirect cost allocation plan was developed and approved and the final disallowance was calculated, HUD staff took aggressive steps to collect the amount due. The delay in collecting the disallowed amount (4 months) was due to the City Council's lengthy procedures in reaching a decision as to whether they wanted to repay the disallowances by using general funds or by reducing the community development block grant. They decided to reduce the grant and this action was carried out on November 13, 1981 by HUD.

ENCLOSURE 9

CASE NUMBER HUD-3

Auditee: Owens Valley Indian Housing Authority

Current Status

Finding 5 contained $18,000 of questioned costs. The amounts involved were owed to the Owens Valley Indian Housing Authority (OVIHA), not HUD. HUD's actions were in accordance with the audit recommendation and the Regional Inspector General for Audit (RIGA) concurred in the closing of the finding. The finding was submitted for closure only after the fee accountant, on behalf of OVIHA, transferred the disputed expenditures to the Ineligible Expense Account, and recorded them as accounts receivable by OVIHA.

Finding 8 originally contained $11,234 in ineligible costs. Again, the finding was handled in accordance with the audit recommendation. The Region IX OIP reports that certain of the disputed amounts were handled administratively before the closing of the audit. For instance, $1,428 of the amount was a legitimate development expense in accordance with correspondence dated April 21, 1980, and $647 of the disputed travel was approved by letter of August 14, 1980. As to the remainder, the Authority has been instructed by letter that it has responsibility for collection of these funds. A letter to the housing authority indicates that closing of the finding "does not relieve OVIHA of its responsibility to collect these monies."

ENCLOSURE 10

CASE NUMBER HUD-4

Auditee: County of Sacramento, California

Current Status

This audit was cleared with a grant condition on June 17, 1981. The $22,495 was actually recovered October 15, 1981, by means of the following year's grant of $5,318,000 being reduced by that amount. Resolution of the audit finding was delayed because the issue was held up by a grand jury investigation. The 90-day delay in the reduction of the grant was necessary to allow the county to reimburse the CDBG Program from general funds.

The Area Office agrees with the GAO assessment that the subgrantee should have reimbursed the CDBG Program and made every effort to ensure that this was done, but the subgrantee was insolvent. This is often a problem with nonprofit subcontractors. Additionally, if a grant is reduced, there is no way of assuring that grant performance will not be reduced. This reduction, of $22,495, is not likely to reduce the county's performance to any degree, since its total Fiscal Year 1982 grant is $5,295,505.

ENCLOSURE 11

CASE NUMBER HUD-5

Auditee: Subgrantees of City of Los Angeles

Current Status

There were two separate audits--Model Cities Programs, issued July 10, 1980, and city's CDBG Program, issued June 30, 1980. Total amount of these audits comes to $501,266 of disallowed costs not collected or returned. Resolution of each was processed independently.

MODEL CITIES PROGRAM

Subgrantee/Auditee	RIGA Recommended Disallowances
Community Concern	$15,327
Greater Watts Economic Development Corporation	$54,768

These two were contained in a closeout audit of the Model Cities Program. They were part of a $180,919 finding (Finding 1) by the Inspector General recommending removal of ineligible expenditures from the program costs. The City of Los Angeles was notified about the disallowance and advised by HUD to remove these costs from the final accounting records for the closeout of the program.

The City indicated that it did not wish to pay back the disallowed costs in cash. The City offered to offset the disallowed amounts with other costs, funded by the City, which would have been eligible for inclusion in computing the City's share of the Model Cities grant. As a result of these negotiations, the grantee removed the disallowed program costs from the Model Cities accounting records and substituted other allowable costs. The Regional Office of Inspector General reviewed these additional items and allowed the costs as an offset against the disallowed costs. The finding was cleared by the RIGA on September 23, 1981.

CDBG PROGRAM

Subgrantee/Auditees	RIGA Recommended Disallowances
Yellow Cab Co. - Dial-a-Ride	$ 9,612
Narcotics Prevention Project	$ 86,220
East Los Angeles Improvement Assoc.	$105,803 $229,536

These three were contained in a RIGA audit of the City of Los Angeles' CDBG Program. The RIGA recommended the disallowances as part of a finding (Finding 5) which stated that the grantee did not reimburse the CDBG Program for costs which had been disallowed by the City's own internal auditors. The City submitted evidence that the $9,612 which was disallowed for the Yellow Cab Company Dial-a-Ride Program was not funded by block grant funds but by City funds. This evidence was reviewed and accepted by HUD and the City was advised on January 23, 1981 that the $9,612 questioned amount for the Yellow Cab Company Dial-a-Ride was cleared.

During the negotiations with the City for the collection of the debt, the City submitted additional information which supported acceptance as eligible costs $56,025 of the disallowed amount. Consequently, the claim against the City for the Narcotics Prevention Program disallowance was reduced to $30,195.

The $335,339 which was disallowed for the East Los Angeles Improvement Association - Demand Response Transportation Program - was sustained by HUD and the City was requested to reimburse the CDBG Program for the disallowed cost.

Since the City has not reimbursed the disallowed amount to HUD, the outstanding debt of $365,534 on these two subgrantees was referred to HUD's Claims Collection System for collection.

A demand for payment was made on the City and it has indicated to HUD that it wishes to arrange for a non-cash reimbursement payment to resolve the debt. This request by the City is still under study by the HUD Area Office.

ENCLOSURE 12

CASE NUMBER HUD-6

Auditee: City and County of San Francisco (Subgrantee: Ambulatory Health Care Facility)

Current Status

After a prolonged attempt to recover the $17,380 in disallowed costs from the Subgrantee, the City terminated funding of the Subgrantee as of October 31, 1981. The Subgrantee has obtained the services of an accountant to put its financial records in order. Once this is completed, the City will have an audit of the Subgrantee conducted by an Independent Public Accountant. After the audit is completed, the City has indicated that it will be prepared to take legal action against the Subgrantee in order to recover any funds which were not properly expended.

ENCLOSURE 13

CASE NUMBER HUD-7

Auditee: City of Oakland, California (Grantee); Oakland Better Housing, Inc. (Subgrantee)

Current Status

The amount of $6,652 which was still owed by the Oakland Better Housing, Inc. (OBHI), as of July 1, 1981, has now been paid.

THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

RECEIVED
MAY 3 1982
Legislation and National Security Subcommittee

April 30, 1982

RECEIVED
MAY 1 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman, Committee on Government
Operations
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This is in response to the General Accounting Office (GAO) Report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits," dated January 22, 1982.

Prior to the issuance of the GAO report, the Department had been aware that changes were needed in the audit resolution and debt collection systems and had already taken steps for improvement. For instance, certain changes had been instituted on tightening time requirements for making determinations on external audit findings; on intradepartmental reporting of debt collection activity; and on procedures for controlling the collection of audit-related debts.

The Department of Housing and Urban Development (HUD) is in the process of issuing additional procedures on audit resolution and related debt collection which will bring us into full compliance with Federal claims collection regulations and the Office of Management and Budget (OMB) guidelines. Our audit follow-up system is described in HUD Handbook 2000.6, Audits Management System (AMS). This Handbook has been revised to comply with existing OMB guidelines and the Supplemental Appropriations and Rescission Act of 1980 and is in the process of being printed. The new procedures require resolution of audit findings by action officials within 4 months or they are referred to Headquarters for resolution with a determination required within 2 months in order to meet OMB's 6-month time frame for resolution. Even though the Handbook is still in clearance, the procedures which require resolution within 6 months have been implemented.

In addition, HUD's Office of Finance and Accounting has developed a draft Notice entitled, "Financial Control Requirements for Sustained Costs Resulting from Inspector General Audit Findings," which is also in Departmental clearance. This Notice contains procedures for recording, collecting and aging those sustained audit findings which represent debts, as well as instructions for assessing interest on such debts.

Before addressing the individual recommendations, several general comments are in order concerning "debts arising from audits." First, audit findings at

HUD that reflect disallowed costs do not necessarily result in a debt owed to HUD or the Federal Government. In many cases, because of the nature of the statutory and regulatory structure of the programs involved, the audit disallowance may not create a debt at all, or the disallowed costs may be owed to a HUD-insured or -funded housing project, to a program account, or even to program beneficiaries, rather than directly to HUD or the Federal Government. Thus, it is not appropriate to set up accounts receivable in favor of the Government until there has been a determination as to whether the audit disallowances are due and owing to HUD. Secondly, in the Community Development Block Grant (CDBG) Program, legislation permits reduction in future grant amounts as a means to settle audit disallowances.

I will respond to the recommendations made on Pages 17, 18, 25, and 28 of the GAO report in the order in which they were presented:

Page 17, Recommendation 1

"Require a written determination of the allowability of all questioned costs within 6 months of audit report issuance."

Response

HUD agrees with the recommendation and is implementing it. Our current procedure requires that all findings have a written determination made by our Field Offices within 120 days. If a determination is not made within 120 days, the findings are referred to higher levels of management for resolution. If they are not resolved within 6 months, they are referred to the Under Secretary who makes the final determination. This procedure became effective November 18, 1981.

Page 17, Recommendation 2

"Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness."

Response

The Department agrees with this recommendation. A Notice is in clearance for issuance to provide departmental procedures for all offices involved in disallowed cost actions. The Notice provides a timetable for completing all required actions within 30 days after notifying the debtor (including recording of the receivables), once an audit finding is sustained and determined to represent a debt.

Page 17, Recommendation 3

"Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of funding."

Response

We agree with this recommendation. The Department's Claims Collection Handbook now requires that written demand for payment be sent at 30-day intervals to debtors. The Department also collects outstanding debts by offsetting debts against other HUD programs where permissible.

We are currently updating the Claims Collection Handbook to incorporate recent changes to the Federal Claims Collection Standards. Recommended collection actions (affecting debtors' credit ratings, offsetting debts against amounts due from other Federal programs and suspending or terminating funding) will be considered for adoption after the Department has determined that statutes and regulations permit such actions.

Page 18, Recommendation 4

"Hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees."

Response

The Department agrees with this recommendation. HUD adheres to the general principle that grantees are responsible for audit-related debts of subgrantees absent a statutory, regulatory, or contractual provision to the contrary. (For this purpose, a subgrantee is any party receiving grant funds through the grantee.)

Page 25, Recommendation 5

"Ensure compliance with the Claims Collection Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less."

Response

The Department agrees with this recommendation. We will clarify, in the HUD Claims Collection Handbook, procedures that need to be followed to preclude termination of debts over $20,000. With regard to setting debts under $20,000, the Claims Collection Officers currently are advised to consult either GAO or the appropriate Counsel's Office to obtain proper counseling.

Page 25, Recommendation 6

"Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal."

Response

Auditees are given several opportunities to express their views and provide additional information in the audit resolution process. Our procedures require this to be done before the audit findings are sustained. This process is established in our Audits Management System Handbook.

At the audit exit conference, auditees can tell the auditors directly that they disagree with the findings or provide additional information to clarify an issue. Their disagreement(s) or clarification(s) would then be incorporated in the audit report. Once the report is issued to program officials, the auditee is given another chance to express his/her views and provide further information. The program official analyzes the auditee's comments and information in relation to the finding. If the program official agrees with the auditee, the finding can be resolved in favor of the auditee. In this case, if the Office of Inspector General (OIG) disagrees with the auditee and the program officials, the matter is raised to higher levels of management in Headquarters. If the finding cannot be resolved between the program official and the OIG at this level, it is referred to the Field Audits Review Group and the Under Secretary for final determination.

In the event HUD sustains the questioned costs and the auditee disagrees, there is no formal appeal system for most HUD programs. However, if the auditee supplies additional information on the allowability of costs, program officials may reverse the sustained costs. We believe our procedures preclude long appeal processes that GAO reported other agencies experience.

Page 25, Recommendation 7

"Require interest to be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition."

Response

The Department agrees with this recommendation. On September 10, 1981, instructions were issued to all Headquarters and Regional accounting offices requiring interest to be charged on all delinquent receivables (including sustained audit findings which constitute debts) at the rate prescribed by the Treasury Department. The instructions included a provision indicating that where charging interest is prohibited by statute, contract, or regulation, or a different rate is mandated, the rate of interest would be adjusted accordingly.

A Notice is presently being prepared by the Office of Finance and Accounting to provide Departmentwide procedures for all offices involved in the full range of actions for audit-related debts, including a provision for assessment of interest on such debts, if they are not paid within 30 days. In addition, another issuance being prepared to provide guidance for the proper handling of all debts owed to the Department, also will require the appropriate assessment of interest on delinquent debts.

Page 28, Recommendation 8

"We recommend that heads of departments and agencies require grantee debtors to certify that their payment of audit-related debts has not reduced the level of performance of any Federal program. We further recommend that a followup system be established whereby grant management staff closely monitor performance of grantees to ensure that settlement of debts does not adversely affect grantee performance. This system should also include provision for audit follow-up, whereby routine verification is made part of the subsequent audit of grantees paying off audit-related debts."

Response

HUD disagrees with the recommendations as they are stated. The current Administration policy is to reduce the reporting burden on State and local Governments. The certification would increase the burden. In order to have both program officials and auditors follow up on the grantee's performance and the certification a 100 percent examination of the source of funds and expenditures may be necessary. This would be contrary to generally accepted auditing standards, which call for testing expenditures on a sample basis, and would be time-consuming, expensive and impractical.

We would like to point out that current audit procedures already exist to detect whether Federal funds are used for ineligible expenditures. When audits are conducted for HUD-funded programs, the auditors test financial transactions to assure that expenditures are acceptable. If the auditor were to find that HUD funds were used improperly to pay audit-related debts of other Federal agencies, the costs would be disallowed. Likewise, other agencies' audit procedures should require the same verifications. In the example cited in the GAO report, where GAO found Comprehensive Employment and Training Act (CETA) funds were used to pay a HUD-related debt, the CETA funds had not been audited by the Department of Labor. We believe the current audit approach is sufficient to provide safeguards against Federal funds being used to pay debts to other agencies.

Since 1975, HUD's Office of Community Planning and Development has used a variety of alternatives to resolve audit disallowances in the CDBG Program. The underlying statutory sanction is the authority to reduce future entitlement grants. Generally, this sanction is used only if the grantee does not: (a) repay by reimbursing its letter-of-credit from local or other sources; (b) reprogram funds from other activities; or (c) increase its local support of eligible community development activities in an amount equal to the disallowance.

CDBG regulations further require that HUD add back to the State program balances or to the entitlement fund balances (within the same Standard Metropolitan Statistical Area) any amount recovered by audit resolution. Therefore, the overall intended benefits of HUD programs are not decreased.

A similar letter is being sent to Senator William V. Roth, Jr., Chairman, Committee on Governmental Affairs, United States Senate.

Very sincerely yours,

Samuel R. Pierce, Jr.

CASE EXAMPLES SUBMITTED TO THE DEPARTMENT OF LABOR

CASE NUMBER DOL-1

DEPARTMENT OF LABOR

Program: Comprehensive Employment and Training Act (CETA)

Audit Report Number and Date: 09-80-C-041-P1, issued 09/12/80

Auditee: Alameda County Training and Employment Board (ACTEB)

Amount questioned: $358,913

Amount disallowed: $384,538 a/ $151,235 (revised)

Date of disallowance: 01/12/81 01/22/81 (revised)

Recovery Action Taken: None taken by DOL as of August 1981.

Appeal status: unresolved as of August 1980

01/22/81 - appealed	$338,598
01/29/81 - revised appeal to	105,295
08/17/81 - revised appeal again to less than	90,000

CASE FACTS:

01/29/81	The prime sponsor, ACTEB, appealed $105,295 of the $151,235 in disallowed costs cited by DOL in the determination of 01/22/81.
08/17/81	As a result of negotiations between DOL and the grantee the amount under appeal was reduced to less than $90,000.
08/20/81	ETA had listed the entire amount of disallowed costs ($151,235) as under appeal and no collection actions had been made on the non-appealed balance exceeding $60,000.
08/31/81	DOL officials admitted that non-appealed portions of disallowed costs seem to "fall through the cracks" temporarily and that this is a weakness in their system.

PRESENT STATUS: open as of 08/31/81

GAO ASSESSMENT:

Due to lack of communication from DOL's solicitor's office handling the appeal negotiations, DOL's Financial and Grants Management Section handling debt collection failed to identify non-appealed portions of disallowed costs and therefore had not pursued collection 7 months after the debt had been established.

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a/This amount exceeded the amount questioned in the audit report because additional unallowable costs were identified in the interim.

CASE NUMBER DOL-2

DEPARTMENT OF LABOR

Program: Comprehensive Employment and Training Act (CETA)

Audit Report Number and Date: 09-80-C-069-020, issued 04/28/80

Auditee: County of Los Angeles (prime sponsor); City of Carson (subgrantee)

Amount questioned: $143,973

Amount disallowed: $ 44,615

Date of disallowance: 06/24/80

Recovery Action Taken: collection waived 10/31/80

Appeal status: no appeal filed

CASE FACTS:

06/24/80	L.A. County disallowed subgrantee questioned costs related to ineligible participants totalling $44,615 of the City of Carson, and informed the City and DOL of this determination.
07/07/80	The City of Carson notified L.A. County that it would appeal the County's disallowance to DOL if required to repay the disallowed costs.
09/17/80	L.A. County requested DOL to allow the disallowed costs based on a provision of its regulations which gives Grant Officers authority to "allow" otherwise disallowable costs if five requirements are met, the last being that "the magnitude of questioned costs or activities is not substantial."
10/31/80	DOL's Grant Officer agreed to waive collection of the costs on the basis that all these requirements had been met.

PRESENT STATUS Closed. Collection of disallowed costs totalling $44,615 was waived 10/31/80.

GAO ASSESSMENT:

Although DOL regulations give Grant Officers the authority to "allow" otherwise disallowable costs under some circumstances, one requirement stipulates that "the magnitude of questioned costs or activities is not substantial." It would seem that this requirement could not be legally met when the otherwise disallowable costs exceed the $20,000 limit set by the Federal Claims Collection Standards for agency discretion in terminating claims.

DEPARTMENT OF LABOR RESPONSE

U.S. DEPARTMENT OF LABOR
SECRETARY OF LABOR
WASHINGTON, D.C.

MAY 6 1982

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HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman
Subcommittee on Legislation and
National Security
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter dated February 24, 1982, regarding a General Accounting Office (GAO) report entitled "Federal Agencies Negligent in Collecting Debts Arising from Audits." Please accept my apology for the delay in responding to your letter.

Enclosed are the answers to the questions contained in your letter and our responses to recommendations made in the GAO report. Please contact me if you need further assistance.

Sincerely,

Raymond J. Donovan

Raymond J. Donovan

Enclosures

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Security Subcommittee

Responses to Questions from Congressman Jack Brooks, Chairman of the Subcommittee on Legislative and National Security, Committee on Government Operations

(1) Question: At what point in the audit resolution process does the Department of Labor (DOL) sustain a questioned cost as an audit disallowance and establish a claim?

Answer: Within the Department, the overwhelming majority (99.7% of dollars questioned and 91% of reports issued) of grant or contract audits which can result in questioned costs are associated with activities of the Employment and Training Administration (ETA). Therefore, the responses to the questions will relate to policies and practices pertaining to those audits.

ETA establishes the debt as a receivable in its accounting system when questioned costs are resolved through a final determination issued by the grant officer or contracting officer. The debt is established at that time whether or not it is appealed to an Administrative Law Judge (ALJ) or the Contract Board of Appeals. This has been official ETA policy since August 1978.

It should be noted, however, that a receivable cannot be considered a claim, for purposes of the Federal Claims Collection standards, until final agency action is complete, including conclusion of any administrative appeals. Thus, many DOL receivables are under appeal before ALJs or the Contract Board of Appeals, and collection action cannot be resumed until the appeal is concluded.

(2) Question: How does the Department assure itself that the funds it receives in payment of audit disallowances are not Federal funds or do not reduce the intended benefits of DOL programs?

Answer: The final determination specifies that: (1) the debt must be repaid from non-Federal sources; and (2) if ETA is forced to apply its offset-type remedy (withholding current funds), the grantee will be required to maintain undiminished grant expenditures and services, or the grant will be terminated in whole or in part. The debt will not be considered collected by ETA's offset-type remedy until, on the basis of a final grantee cost report, expenditures exceed Federal payments by the amount of the debt, thus insuring that intended benefits are not reduced. Auditors audit (usually within 2 years of expiration of the grant or annual plan) all costs and payments reported on grantee financial reports. If any costs are questioned and found unallowable, they will be disallowed when the audit report is resolved, as explained in #1 above.

The ETA agrees with the GAO report that cash repayments should be accompanied by a certification that the funds were drawn from non-Federal sources. We are modifying our debt collection policy to require this certification.

(3) Question: Since 1979, the Federal Claims Collection Standards have required the charging of interest on all delinquent debts. Why has the Labor Department not been assessing interest on delinquent audit-related debts? When will this requirement be fully implemented?

Answer: The ETA does assess and collect interest on delinquent debts. The ETA implemented the Federal Claims Collection requirement regarding interest on January 1980, when ETA revised its debt collection manual. This policy was reiterated and updated in Field Memorandum No. 84-81, dated January 12, 1981.

ETA's first interest charge and collection was formally reported to the Department's Office of the Comptroller on Statement of Receivables forms for the quarters ending September 30, 1980 and March 31, 1981, respectively.

Until recently, ETA did not have adequate means of monitoring the activities of its Regions in charging and collecting interest. ETA's automated accounts receivable system now reflects these charges and collections. By September 30, 1982, we expect automated system output reports to show sizable interest charges and collections.

(4) Question: What is Labor's position on holding grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee?

Answer: ETA holds the grantee ultimately responsible for subgrantee debts. In fact, the Committee on Government Operations noted this fact on Page 19 of its report dated September 29, 1980, subject: "High-Level Emphasis on Accountability Needed in CETA."

(5) Question: GAO found several examples of DOL allowing disallowable costs in excess of $20,000 on the basis of a DOL regulation which states, in part, that "the magnitude of questioned costs or activities is not substantial." How does DOL justify such action when the magnitude of these costs exceeds the $20,000 limit set by the Federal Claims Collection Standards for agency discretion in determining claims?

Answer: In the cases in question, ETA had explicit authority to allow the questioned costs. This authority is provided by Section 676.88(c) of the CETA regulations, which in turn, is based on authority in the CETA statute. Section 676.88(c) provides five criteria that, if applied to certain questioned costs, must be met before such costs may be allowed.

Termination of a claim involves writing off a valid claim as uncollectible. Compromise involves an agreement for writing off a valid claim as uncollectible in exchange for partial payment of that claim. Thus, termination and compromise are unrelated to the case in question, which never got to the point of a valid debt (or claim) nor to the issue of collectibility.

In short, the costs in question were allowed; there was no debt or claim involved; no claim was terminated or compromised; and the $20,000 limit is not relevant.

The real issues would appear to be these:

- -- Could the costs be allowed in light of Comptroller General Decision B-163922? This decision, as noted in the GAO report, established guidelines for allowing and disallowing costs.
- -- Were the allowed costs of "substantial magnitude" and, therefore, unallowable in light of DOL's own regulations?

Decision B-163922 states in part:

> "The published regulations of the Department of Labor under Section 12(a) of EEA, P.L. 92-54, 85 Stat. 153 had the force and effect of law until modified by further regulations. . . In the absence of explicit authority to do so, regulations cannot be waived by the Department of Labor, 37 Comp. Gen. 820 (1958). When faced with the need to interpret regulations, we give great weight to an agency's own interpretation of its own regulations (see 55 Comp. Gen. 427 (1975) and case cited at 429), but here we are not faced with a conflict over interpretation. As previously noted, the officer who allowed the expenditures acknowledged that the expenditures did not meet the requirements of the regulations." (Emphasis added.)

ETA's interpretation of its own regulations, as applied to the audit of the County of Los Angeles, was that the questioned cost of $44,615 was not substantial in light of the total amount audited.

The $44,615 involved the salaries and fringe benefits of three participants "whose eligibility," in the words of the audit report, "appeared questionable or could not be determined." The audit was a subgrantee audit covering three subgrants with the City of Carson and was not an audit of the prime sponsor itself. The $44,615 represented 2 percent of funds expended under the three audited subgrants.

Accordingly, the ETA grant officer felt that the cost was not significant in light of the amount audited and met the other four allowability criteria at Section 676.88(c). The grant officer allowed the cost and did not establish the debt. ETA (1) had explicit authority to allow such costs, and (2) made a defensible decision in interpreting and applying that authority. No debt or claim was ever established, terminated or compromised and, therefore, the $20,000 limit is not pertinent.

(6) Question: A large amount of DOL's audit recoveries are in the form of book adjustments and alternative-to-cash agreements. What is DOL doing to assure that monitoring is adequate to determine if:

- -- book adjustments actually take place,
- -- repayments are made with non-Federal funds, and
- -- the program actually receives the services contracted for in alternative-to-cash repayments.

Answer: Each of the three parts of the question will be addressed separately.

By "book adjustment" we assume you are referring to a method such as that illustrated below:

- -- The grantee agrees that a $10,000 incurred cost is unallowable.
- -- The grantee expunges its grant records of the unallowable cost, transfers the cost to its own non-Federal accounts, and adjusts the letter of credit drawdown report or request form to recognize the payment (made for the unallowable cost) as applicable to the current grant.
- -- This letter of credit transaction is monitored by the regional office when it reviews the drawdown forms, so that ETA can see that the change is made.
- -- The effect of this monitored transaction is to decrease the size of the next drawdown request by the amount of the unallowable cost.

In summary, the letter of credit transaction is monitored and has the effect of taking cash out of the grantee's coffers and adding to cash on hand under the current grant, thereby reducing drawdown requirements. In addition to monitoring the letter of credit transaction, all cost and payment transactions are subject to regular audit.

Our records indicate that "book adjustment" repayments are extremely rare, accounting for only $114,612 in repayments as of March 25, 1982.

In regard to the second part of your question, our response to question #2 addresses assurances that payments are made with non-Federal funds.

> The "alternative-to-cash repayment" is really a repayment in terms of additional CETA services, provided at the grantee's expense, in lieu of cash. These additional services, the cost of which are reported aside from regular grant expenditures, are audited along with regular grant expenditures. ETA will reject any repayment services funded through Federal funds, as specified in the repayment agreement. The repayment agreement gives ETA the right to reject reported repayment services or costs and reinstate the debt at any time, and all such repayment services or costs are subject to audit.

Two DOL cases, noted by GAO, were attached to your questions. One of these cases, concerning the County of Los Angeles, was addressed in our response to question #5.

The other case, concerning Alameda County, concerned an instance wherein the DOL Office of the Solicitor failed to notify ETA that part of an appeal had been withdrawn. In this case, the grantee originally appealed the entire debt, then withdrew a portion (in terms of dollars) without specifying which particular disallowed costs were no longer under appeal. Thus, the Office of the Solicitor was not sure, for some time, what collection instructions to communicate to the grant officer. ETA is amending its debt collection procedures to assure that grant officers are fully aware of their responsibilities in this area. The Office of the Solicitor has informally briefed its regional attorneys regarding their responsibilities in communicating with grant officers. Therefore, we do not expect a repetition of this rather unusual case.

CASE EXAMPLES SUBMITTED TO THE DEPARTMENT OF TRANSPORTATION

CASE NUMBER DOT-1

DEPARTMENT OF TRANSPORTATION

Urban Mass Transportation Administration

Audit Report Number and Date: 75-MID-16 issued 03/15/75

Auditee: Chicago Transit Authority, Chicago, Illinois

Amount Questioned: The Federal share of questioned costs was $1.4 million.

Amount Disallowed: $265,157

Date of Disallowance: 04/24/81

Recovery Action Taken: No recovery as of November 1981.

Appeal Status: No appeal filed.

CASE FACTS:

03/15/75 - Audit report issued with questioned costs of $1.4 million resulting from the grantee's improper retention of project properties, unsupported costs, unapproved third party obligations and improper payments. Audit report was sent to the grantee on 03/31/75.

04/29/75 - Grantee and UMTA regional officials met to discuss audit findings.

06/23/75
12/03/75
01/05/76 - Grantee sent three partial replies to UMTA on the costs in question.

01/24/78 - UMTA Regional Office requested grantee to respond to the audit findings.

02/02/78 - Grantee replied indicating it intended to resolve the audit findings.

02/16/78 to 07/07/78 - Grantee submitted seven partial responses. In summary, the grantee agreed to remove about $58,000 from future project costs.

04/09/79 - Grantee submitted another partial response and offered to credit the project $4,828.

10/17/79 - UMTA Regional Office asked grantee for additional information.

01/15/80 to 01/30/80 - Grantee submitted additional information to UMTA.

04/08/80 - Grantee offered to credit the project a total of $14,739.

04/24/81 - UMTA Headquarters requested the grantee to repay $265,157.

06/24/81 - Grantee responded to UMTA Headquarters that it is still negotiating with UMTA regional office.

PRESENT STATUS:

In August 1981, UMTA Headquarters contacted its regional office and found that no negotiations were occurring. As of 11/05/81, the debt was still uncollected.

GAO ASSESSMENT:

It took over 6 years from the date of the audit report for UMTA to demand payment. Since UMTA has no procedures for assessing interest on this debt, the grantee has everything to gain and nothing to lose by delaying final payment. No formal accounting control has been exercised over this debt.

CASE NUMBER DOT-2

DEPARTMENT OF TRANSPORTATION

Urban Mass Transportation Administration

Audit Report Number and Date: 73-MID-23 issued 06/14/73

Auditee: City of Chicago, Illinois, Mayor's Committee for Economic and Cultural Development

Amount Questioned: Federal Share $68,720

Amount Disallowed: Federal Share $55,613

Date of Disallowance: 07/27/79

Recovery Action Taken: Disallowance was recovered 07/08/81 by reducing another of the grantee's fund requisitions.

Appeal Status: No appeal filed.

CASE FACTS:

06/14/73 - Audit report issued with questioned costs of $68,720 for unallowable and unsupported costs of the grantee.

10/24/73 - Audit report was sent to the grantee with a request for comments in 30 days.

04/16/74 - Grantee submitted partial response to UMTA.

09/11/78 - UMTA officials believed collection action should be initiated. (No receivable had been established)

07/27/79 - UMTA demanded payment from the grantee for $55,613.

09/17/79 - Grantee requested extra time to reply to the audit findings and on 09/20/79 UMTA approved an extension to 10/25/79.

03/31/80 - UMTA sent a preliminary determination letter to the grantee.

05/14/80 - Grantee responded to UMTA that payment was not forthcoming.

02/05/81 - UMTA informed the grantee "we are deducting the $55,613 from the $658,029 that the grantee has requisitioned under project IL-09-0045."

UMTA subsequently processed this requisition but neglected to deduct the disallowance from the $658,029 which was sent on 04/06/81. The City of Chicago subsequently learned that UMTA had already paid them the $658,029 on 06/17/80, almost a year earlier.

05/14/81 - The City of Chicago sent back the duplicate payment of $658,029 to UMTA.

07/08/81 - UMTA deducted the $55,613 disallowance from another requisition thus recovering the disallowance.

PRESENT STATUS:

Funds recovered, case closed.

GAO ASSESSMENT:

An example of an excessive amount of time taken by UMTA to resolve the questioned costs as it took over 6 years from the issuance of the audit report to the date UMTA disallowed the costs and demanded payment from the grantee. Also, this case is an example of extremely poor accounting controls over the debt. In an attempt to collect the debt by offset the agency made a duplicate payment to the grantee of $658,029.

CASE NUMBER DOT-3

DEPARTMENT OF TRANSPORTATION

Urban Mass Transportation Administration

Audit Report Number and Date: 78-03-V-13 issued 6/26/78

Auditee: City of Lansing, Michigan, Projects MI-03-0028 and MI-03-0015

Amount Questioned: The Federal share of questioned costs was $28,996

Amount Disallowed: The Federal share of disallowed costs was $28,996

Date of Disallowance: 10/10/79

Recovery Action Taken: Funds recovered 9/29/81

Appeal Status: No appeal filed.

CASE FACTS:

06/26/78 -	Audit report issued stating overpayments totaling $28,996 were made to the grantee on two of its projects.
07/07/78 -	UMTA regional office sent the report to the grantee for their comments within 30 days.
02/27/79 -	Grantee replied and asked that questioned costs be allowed.
10/10/79 -	UMTA's regional office informed the grantee that the questioned costs were disallowed and demanded payment. No accounts receivable were established.
05/18/81 -	GAO discussed this case with UMTA regional officials who could find no evidence of collection action beyond the 10/10/79 letter.
05/29/81 -	UMTA regional office sent a letter to the grantee stating that unless there was evidence that an earlier settlement was made to UMTA, immediate remittance should be made.
07/27/81 -	Grantee replied to UMTA attempting to provide supporting information and requested that the costs be allowed.
08/17/81 -	UMTA officials wrote the grantee that the costs remained disallowed and demanded payment.
09/29/81 -	Grantee made payment by check for the full amount of the disallowance.

PRESENT STATUS:

Audit closed, UMTA has recovered from the grantee.

GAO ASSESSMENT:

UMTA officials did not establish adequate controls and did not follow up to ensure that collection of the debt was made. Accounting controls should be established over all disallowances. As a result of not collecting the disallowance in a timely manner the grantee had use of the disallowed funds for almost 2 years.

CASE NUMBER DOT-4

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

Audit Report Numbers and Dates: 79-16-45 issued 09/24/79
81-17-162 issued 06/02/81

Auditee: Capitol City Railroad Relocation Authority (Subgrantee of Illinois Department of Transportation (IDOT))

Amount Questioned: The Federal share of questioned costs was $48,722

Amount Disallowed: The Federal share of disallowed costs was $48,722

Date of Disallowance: 08/29/80

Recovery Action Taken: Funds recovered with billing corrections 06/81

Appeal Status: No appeal filed.

CASE FACTS:

09/24/79 - Audit of subgrantee issued by State, which questioned $51,286 (Federal share $48,722) improperly claimed for aerial photography work actually performed by the State but billed by subgrantee and paid by FHWA. The State also received payment from FHWA for this work.

08/29/80 - State set up accounts receivable for the $51,286 owed by the subgrantee.

06/18/81 - State offset overpayments from billings to FHWA to cover the duplicate payments.

PRESENT STATUS:

Case closed, funds recovered by reductions from billings by State to FHWA.

GAO ASSESSMENT:

The State had $48,722 of Federal funds for almost two years prior to repaying FHWA. The grantee should be held accountable for prompt return of identified Federal overpayments. No interest was collected by the Federal Government.

DEPARTMENT OF TRANSPORTATION RESPONSE

U.S. Department of Transportation
Office of the Secretary of Transportation

Assistant Secretary
for Administration

400 Seventh Street, S.W.
Washington, D.C. 20590

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APR 25 1982
Legislation and National Security Subcommittee

The Honorable Jack Brooks
Chairman, Legislation and
National Security Subcommittee
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter dated February 24, 1982, requesting our comments on the General Accounting Office (GAO) final report, "Federal Agencies Negligent in Collecting Debts Arising from Audits," AFMD-82-32 dated January 22, 1982.

GAO reports that Federal agencies are doing a poor job of managing and collecting audit-related debts owed by contractors and grantees such as State and local governments. GAO concluded that most agencies do not know the total amount owed them, nor do they collect debts promptly or charge the required interest when payments are late. When debts are paid the agencies usually do not know whether the amounts received have been taken from their own or other Federal programs. Also, some Federal agencies avoid collecting some of their debts altogether. GAO makes specific recommendations which it believes will improve the agencies' collection systems. It also recommends that the Office of Management and Budget (OMB) incorporate these recommendations into the management circular on audit resolution and follow-up to ensure that agencies are complying.

We agree in general with all of the GAO recommendations, and for the most part our practices and procedures are consistent with them. We cannot conclude from the report the extent to which the weaknesses cited by GAO exist within the Department of Transportation (DOT). However, we agree that considerable improvement can be made in our management and collection of audit-related debts.

We have several actions in process as well as existing procedures which will fulfill the intent of the GAO recommendations. For example, we are in the process of revising the Departmental directive on audit report findings, recommendations, and followup action. This directive currently sets forth the responsibilities of DOT officials for followup actions, establishes specific time frames in which followup actions should occur, and provides for the establishment of accounting and collection controls for amounts due the government as a result of audit. Although this Order currently requires audit resolution within 6 months of report issuance, it is being revised to reference Public Law 96-304 enacted July 8, 1980, which requires resolution within 6 months as a matter of law.

Departmental financial policy with respect to debts due the Department is contained essentially in DOT Directive, Financial Management of Receivables which provides policy and guidelines on the establishment, management, collection, and reporting of all receivables generated by activities of the Department. This directive is based upon the Federal Claims and Collection Standards, GAO standards and requirements, and Treasury Department regulations, all of which were referred to in the GAO report. Audit disallowances are specifically included in the definition of receivables subject to the provisions of this directive, and therefore such debts (audit disallowances) are required to be recorded as receivables, monitored, collected, and reported on in the same manner as any other type of debt due the Department. Requirements for charging interest on overdue debts are also provided for in this directive.

Although audit disallowances are presently contained within the scope of the DOT receivable management directive, we plan to expand and strengthen our policy guidance with more specific reference to the accounting control requirements of audit-related debts. In this regard, we have previously been advised informally that OMB will be issuing uniform government-wide requirements on accounting for audit disallowances. We will incorporate the OMB guidance, when issued, in our directives.

Also, plans for improved accounting control over audit disallowances for certain departmental administrations were included in their individual debt collection action plans submitted to OMB in response to OMB Bulletin No. 81-17 on Debt Collection, dated April 27, 1981.

In summary, we believe the actions we are currently taking will fulfill the intent of the GAO recommendations. We are confident that the Department's management and collection of audit-related debt will be considerably improved, upon the completion of these actions.

Your letter also requested our response to some specific questions on this subject and the current status on four collection cases. Our responses to these are enclosed.

Sincerely,

Karen S. Lee

for Robert L. Fairman

Enclosures

ENCLOSURE I

SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY'S QUESTIONS FOR THE DEPARTMENT OF TRANSPORTATION IN CONNECTION WITH SUBCOMMITTEE HEARING OF FEBRUARY 24, 1982 - FEDERAL DEPARTMENTS' AND AGENCIES' FAILURE TO COLLECT AUDIT-RELATED DEBTS

1. At what point in the audit resolution process does the Department of Transportation sustain a questioned cost as an audit disallowance and establish a claim? What conditions must be met?

   A claim is established at the time management agrees with the audit recommendation and notifies the grantee/contractor of the disallowance. Of course, this follows a thorough review by Departmental officials of the costs questioned to determine the amount of the disallowance. We have to assure ourselves that the questioned costs were in fact not in accordance with applicable statute, regulation, etc. This review of the audit findings may vary slightly among our operating elements. We understand that a forthcoming OMB requirement will more specifically address the point of claims establishment and conditions to be applied uniformly throughout the Federal Government. The OMB requirement will be incorporated in our policy directives.

2. How does the Department assure itself that the funds it recieves in payment of audit disallowances are not Federal funds or do not reduce the intended benefits of DOT programs?

   In general, funds are provided to DOT grantees for reimbursement of allowable costs. Therefore, if the project is completed in accordance with the grant we can be reasonably assured that Federal funds were spent for only project related items. However, we will still rely on follow-up audits of grantees and subgrantees to determine if funds repaid as a result of audit disallowances are Federal funds.

3. Since 1979, the Federal Claims Collection Standards have required the charging of interest on all deliquent debts. Why has the Transportation Department not been assessing interest on deliquent audit-related debts? When will this requirement be fully implemented?

   The Department's policy requires charging of interest on delinquent debts. However, we do recognize the need to strengthen our procedures on charging interest on audit-related delinquent debts.

4. What is Transportation's position on holding grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee?

   It is the Department's position to hold grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee.

Enclosure 2

CASE NUMBER DOT-1

Department of Transportation

Urban Mass Transportation Administration

Audit Report Number and Date: 75-MTD-16 issued 03/15/75

Auditee: Chicago Transit Authority, Chicago Illinois

Amount Questioned: The Federal share of questioned costs was $1.4 million.

Amount Disallowed: $265,157

Date of Disallowance: 04/24/81

Recovery Action Taken: No recovery as of November 1981.

Appeal Status: No appeal filed.

CASE FACTS:

03/15/75 - Audit report issued with questioned costs of $1.4 million resulting from the grantee's improper retention of project properties, unsupported costs, unapproved third party obligations and improper payments. Audit report was sent to the grantee on 03/31/75.

04/29/75 - Grantee and UMTA regional officials met to discuss audit findings.

06/23/75
12/03/75
01/05/76 - Grantee sent three partial replies to UMTA on the costs in question.

01/24/78 - UMTA Regional Office requested grantee to respond to the audit findings.

02/02/78 - Grantee replied indicating it intended to resolve the audit findings.

02/16/78 to 07/07/78 - Grantee submitted seven partial responses. In summary, the grantee agreed to remove about $58,000 from future project costs.

04/09/79 - Grantee submitted another partial response and offered to credit the project $4,828.

10/17/79 - UMTA Regional Office asked grantee for additional information.

01/15/80 to 01/30/80 - Grantee submitted additional information to UMTA.

04/08/08 - Grantee offered to credit the project a total of $14,739.

04/24/81 - UMTA Headquarters requested the grantee to repay $265,157.

06/24/81 - Grantee responded to UMTA Headquarters that it is still negotiating with UMTA regional office.

PRESENT STATUS:

In August 1981, UMTA Headquarters contacted its regional office and found that no negotiations were occurring. As of 11/05/81, the debt was still uncollected.

GAO ASSESSMENT:

It took over 6 years from the date of the audit report for UMTA to demand payment. Since UMTA has no procedures for assessing interest on this debt, the grantee has everything to gain and nothing to lose by delaying final payment. No formal accounting control has been exercised over this debt.

ADDITIONAL COMMENT

An accounts receivable has been established and collection is being pursued in this case. The UMTA financial management staff is checking with the Chicago regional office to determine why financial records cited by the GAO since March 13, 1975, were not on file in the case file maintained on the account in the Washington Headquarters Office of Financial Management.

Enclosure 2

CASE NUMBER DOT-2

Department of Transportation

Urban Mass Transportation Administration

Audit Report Number and Date: 73-MTD-23 issued 06/14/73

Auditee: City of Chicago, Ilinois, Mayor's Committee for Economic and Cultural Development

Amount Questioned: Federal Share $68,720

Amount Disallowed: Federal Share $55,613

Date of Disallowance: 07/27/79

Recovery Action Taken: Disallowance was recovered 07/08/81 by reducing another of the grantee's fund requisitions.

Appeal Status: No appeal filed.

CASE FACTS:

06/14/73 -	Audit report issued with questioned costs of $68,720 for unallowable and unsupported costs of the grantee.
10/24/73 -	Audit report was sent to the grantee with a request for comments in 30 days.
04/16/74 -	Grantee submitted partial response to UMTA.
09/11/78 -	UMTA officials believed collection action should be initiated. (No receivable had been established)
07/27/79 -	UMTA demanded payment from the grantee for $55,613.
09/17/79 -	Grantee requested extra time to reply to the audit findings and on 09/20/79 UMTA approved an extension to 10/25/79.

03/31/80 - UMTA sent a preliminary determination letter to the grantee.

05/14/80 - Grantee responded to UMTA that payment was not forthcoming.

02/05/81 - UMTA informed the grantee "we are deducting the $55,613 from the $658,029 that the grantee has requisitioned under project IL-09-0045.

UMTA subsequently processed this requisition but neglected to deduct the disallowance from the $658,029 which was sent on 04/06/81. The City of Chicago subsequently learned that UMTA had already paid them the $658,029 on 06/17/80, almost a year earlier.

05/14/81 - The City of Chicago sent back the duplicate payment of $658,029 to UMTA.

07/08/81 - UMTA deducted the $55,613 disallowance from another requisition thus recovering the disallowance.

PRESENT STATUS:

Funds recovered, case closed.

GAO Assessment:

An example of an excessive amount of time taken by UMTA to resolve the questioned costs as it took over 6 years from the issuance of the audit report to the date UMTA disallowed the costs and demanded payment from the grantee. Also, this case is an example of extremely poor accounting controls over the debt. In an attempt to collect the debt by offset the agency made a duplicate payment to the grantee of $658,029.

UMTA COMMENT

UMTA has no further comment on this example, as the funds have been recovered. UMTA Order 2910.1A, "Follow-up Action and Resolution of Office of Inspector General Audit Recommendations" and UMTA Order 2060.1, "Internal Procedures for Handling a Federal Claims Collection Act Case", were issued in 1980 and are now employed by UMTA to ensure that claims are not delayed.

CASE NUMBER DOT-3

Department of Transportation

Urban Mass Transportation Administration

Audit Report Number and Date: 78-03-V-13 issued 6/26/78

Auditee: City of Lansing, Michigan, Projects MI-03-0028 and MI-03-0015

Amount Questioned: The Federal share of questioned costs was $28,996

Amount Disallowed: The Federal share of disallowed costs was $28,996

Date of Disallowance: 10/10/79

Recovery Action Taken: Funds recovered 9/29/81

Appeal Status: No appeal filed.

CASE FACTS:

06/26/78 - Audit report issued stating overpayments totaling $28,996 were made to the grantee on two of its projects.

07/07/78 - UMTA regional office sent the report to the grantee for their comments within 30 days.

02/27/79 - Grantee replied and asked that questioned costs be allowed.

10/10/79 - UMTA's regional office informed the grantee that the questioned costs were disallowed and demanded payment. No accounts receivable were established.

05/18/81 - GAO discussed this case with UMTA regional officials who could find no evidence of collection action beyond the 10/10/79 letter.

05/29/81 - UMTA regional office sent a letter to the grantee stating that unless there was evidence that an earlier settlement was made to UMTA, immediate remittance should be made.

07/27/81 - Grantee replied to UMTA attempting to provide supporting information and requested that the costs be allowed.

08/17/81 - UMTA officials wrote the grantee that the costs remained disallowed and demanded payment.

09/29/81 - Grantee made payment by check for the full amount of the disallowance.

PRESENT STATUS:

Audit closed, UMTA has recovered from the grantee.

GAO ASSESSMENT:

UMTA officials did not establish adequate controls and did not follow up to ensure that collection of the debt was made. Accounting controls should be established over all disallowances. As a result of not collecting the disallowance in a timely manner the grantee had use of the disallowed funds for almost 2 years.

UMTA COMMENT

UMTA has no further comment on this example, as the funds have been recovered. UMTA Order 2910.1A, "Follow-up Action and Resolution of Office of Inspector General Audit Recommendations" and UMTA Order 2060.1, "Internal Procedures for Handling a Federal Claims Collection Act Case", were issued in 1980 and are now employed by UMTA to ensure that claims are not delayed.

Enclosure 2

CASE NUMBER DOT-4

Department of Transportation

Federal Highway Administration

Audit Report Numbers and Dates: 76-16-45 issued 09/24/79
81-17-162 issued 06/02/81

Auditee: Capital City Railroad Relocation Authority (Subgrantee of Illinois Department of Transportation (IDOT)

Amount Questioned: The Federal share of questioned costs was $48,722

Amount Disallowed: The Federal share of disallowed costs was $48,722

Date of Disallowance: 08/29/80

Recovery Action Taken: Funds recovered with billing corrections 06/81

Appeal Status: No appeal filed.

CASE FACTS:

09/24/79 - Audit of subgrantee issued by State, which questioned $51,286 (Federal share $48,722) improperly claimed for aerial photography work actually performed by the State but billed by subgrantee and paid by FHWA. The State also received payment from FHWA for this work.

08/29/80 - State set up accounts receivable for the $51,286 owed by the subgrantee.

06/18/81 - State offset overpayments from billings to FHWA to cover the duplicate payments.

PRESENT STATUS:

Case closed, funds recovered by reductions from billings by State to FHWA.

GAO ASSESSMENT:

The State had $48,722 of Federal funds for almost two years prior to repaying FHWA. The grantee should be held accountable for prompt return of identified Federal overpayments. No interest was collected by the Federal Government.

FHWA COMMENT

The following example was cited on page 16 of GAO's report:

> "--An audit report issued by a State Department of Transportation in September 1979 identified $49,000 in Federal funds improperly paid to a subgrantee for work the grantee itself had performed. Both the grantee and the subgrantee had been paid by the Federal Highway Administration. It was not until June 1981 that billing adjustments were made to recover disallowed costs."

This example is misleading because it implies that the audit report issued in September 1979 identified a duplicate payment for which no adjustment was made until June 1981. This audit report, number 79-16-45, was issued by the Illinois Department of Transportation (IDOT) and recommended the establishment of an accounts receivable invoice for work performed by IDOT for the Capitol City Railroad Relocation Authority (CCRRA). This report did not disclose the duplicate payment by FHWA. Neither FHWA nor IDOT were aware of the duplicate billing until Audit Report No. 81-17-162 was issued on June 2, 1981. Repayment was made by IDOT on June 17, 1981, in the form of a credit to its Federal billing. This is only 15 days after the overpayment was first disclosed.

This overpayment occurred because a unique process was involved and an IDOT employee did not adhere to the special procedure. Normally, IDOT personnel would charge these costs directly to a project, but, in this case, the costs were to be reported to CCRRA for inclusion in its billing. However, the costs were erroneously charged directly to the project and also reported to CCRRA. This was apparently an isolated occurrence involving the failure to follow an established procedure.

This example is also misleading because it states that both the grantee (SHA) and subgrantee were paid by FHWA. Subgrantees are actually paid by the SHA which, in turn, bills FHWA.

This example actually demonstrates the effectiveness of FHWA's procedures.

CASE EXAMPLES SUBMITTED TO THE ENVIRONMENTAL PROTECTION AGENCY

CASE NUMBER EPA-1

ENVIRONMENTAL PROTECTION AGENCY

Audit Report Number and Date: E6A4-05-055-281 issued 9/5/74

Auditee: Wayne County Health Department, Detriot, Michigan

Amount Questioned: $187,071

Amount Disallowed: $177,001

Date of Disallowance: 05/13/80

Recovery Action Taken: A special condition was attached to Wayne County's FY 81 Air Pollution Control Program Grant to establish a repayment plan. See present status.

Appeal Status: No appeal filed.

CASE FACTS:

09/05/74 - Audit report issued with questioned costs relating to salary and fringe benefit charges.

08/04/76 - EPA regional officials wrote the grantee and requested information to make a determination on what part of the questioned salaries could be accepted as reasonable.

06/14/77 - EPA regional officials wrote the Director of EPA's Northern Audit Division and stated they had received a response to the audit report from the grantee and that a final determination of acceptable costs would be provided when the grantee submitted additional information.

08/02/79 - EPA's Northern Audit Division wrote EPA regional officials and requested information on the current status of the report.

02/26/80 - EPA's Northern Audit Division again wrote regional officials with questions regarding the audit report.

04/24/80 - EPA wrote the grantee indicating they had completed their review of the additional information submitted by the grantee. As a result of the review the amount due EPA was determined to be $177,001. The notification was considered final unless a notice of appeal was filed by the grantee.

07/03/80 - A regional official contacted the grantee regarding the status of EPA's determination letter. The grantee responded that repayment of the debt would probably be approved.

02/25/81 - EPA attached a condition to the grantee's FY 81 Air Pollution Control Program Assistant Agreement that within 30 days after acceptance of the award, reimbursement of the debt shall be made or other agreeable repayment arrangements made. Wayne County subsequently proposed a repayment schedule that EPA regional officials did not accept.

10/21/81 - EPA regional officials wrote the grantee indicating their agreement with the grantee's revised proposal to repay the debt in three equal reductions against the grantee's letter of credit on November 30, 1981, 1982, and 1983. Interest will not be charged if the reductions are made as scheduled.

PRESENT STATUS:

Per EPA letter 10/21/81 the grantee is to sign and return to EPA regional officials the repayment agreement.

GAO ASSESSMENT:

EPA took too much time to resolve the questioned costs and then did not pursue the amount disallowed in accordance with the Federal Claims Collection Standards. EPA officials failed to establish proper accounting controls over the debt. Seven years after the audit report was issued, nothing had been recovered. EPA does not plan to charge interest even though it is a requirement of the Claims Collection Standards.

CASE NUMBER EPA-2

ENVIRONMENTAL PROTECTION AGENCY

Audit Report Number and Date: E6A4-05-185-508 issued 10/30/74

Auditee: Michigan Department of Health, Lansing, Michigan

Amount Questioned: $121,959

Amount Disallowed: $121,959

Date of Disallowance: 10/09/80

Recovery Action Taken: No recovery made, case is under appeal as of 10/29/81.

Appeal Status: $121,959 appealed on 11/06/80.

CASE FACTS:

10/30/74 -	Audit report issued with questioned costs of $121,959 Federal share based on a review of total costs claimed.
03/24/77 -	The EPA regional office wrote the grantee and stated it was important to resolve the audit matters so that final settlement could be made.
10/09/80 -	The EPA regional office wrote the grantee demanding payment of $121,959.
11/06/80 -	The grantee wrote the EPA regional office declaring its intent to appeal the decision.

PRESENT STATUS:

As of 10/29/81 an official of the EPA regional office told us the case is still under appeal.

GAO ASSESSMENT:

It took 6 years to take partial action on this audit report. No accounting control was exercised and no interest has been accrued on this delinquent debt.

CASE NUMBER EPA-3

ENVIRONMENTAL PROTECTION AGENCY

Audit Report Numbers and Dates: E6A6-05-454-1381 issued 06/13/77
E6W6-05-455-1382 issued 06/13/77

Auditee: Minnesota Pollution Control Agency, Roseville, Minnesota

Amount Questioned: $49,206

Amount Disallowed: $49,206

Date of Disallowance: 08/16/78

Recovery Action Taken: As of 10/29/81 the disallowance had not been recovered.

Appeal Status: No appeal filed.

CASE FACTS:

06/13/77 - Two audit reports were issued with questioned costs totaling $49,206. The majority of the costs questioned in the reports were for indirect costs charged to grants without proper documentation.

08/16/78 - EPA regional officials issue their disallowance letter to the grantee demanding payment of $49,206. No receivable was established in the accounting records.

02/26/79 - EPA regional officials wrote to the grantee and stated they recognized the potential hardship that could result if the grantee had to reimburse EPA for the disallowance. The regional officials indicated they were willing to consider withholding the amount of the disallowance from future grant awards.

04/26/79 - EPA regional officials agreed to withhold the overpayments from future grants. However, no accounting controls were established.

06/11/81 - GAO discussed the case with a regional official and advised that records showed no indication that the disallowance was ever withheld.

PRESENT STATUS:

As of October 1981, no recovery had been made. GAO at that time contacted a regional official to determine what action had been taken to recover the disallowance. The regional Chief of Financial Operations indicated they were planning to contact GAO to find out who the grantee was and what audit was involved. GAO again provided the needed information to begin recovery of the debt.

GAO ASSESSMENT:

A formal account receivable was not established in this case. EPA regional officials have failed to take the action necessary to collect the disallowance. When GAO initially discussed the case with regional officials they failed to act promptly. The regional officials apparently placed a low priority on collecting this debt. Furthermore, offsetting the debt from a future award to "minimize hardship on the grantee" suggests that performance under the future offset grant will be reduced by the amount of the debt - thus no recovery.

ENVIRONMENTAL PROTECTION AGENCY RESPONSES

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

APR 6 1982

Honorable Jack Brooks
Chairman, Committee on
Government Operations
House of Representatives
Washington, D.C. 20515

RECEIVED
APR 12 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

OFFICE OF
POLICY AND RESOURCE MANAGEMENT
RECEIVED
APR 13 1982
Legislation and National
Security Subcommittee

Dear Mr. Chairman:

Thank you for the opportunity to review the recent General Accounting Office (GAO) report, "Federal Agencies Negligent in Collecting Debts Arising from Audits" (AFMD-82-32), and to respond to the specific questions posed by the Subcommittee on Legislation and National Security. On several occasions, the Administrator has said that a significant priority of hers is the correction of past deficiencies in the Environmental Protection Agency's (EPA's) audit resolution and debt collection practices. The deficiencies cited by GAO are the result of historically low priority and lax management and clear cases where better management can produce savings for the Agency and the government.

EPA managers have already taken aggressive action to ensure that audit-related receivables are identified, accounted for and collected. We have implemented policies enforcing interest charges on all delinquent receivables, including those under appeal. Last August we amended EPA's audit follow-up system to conform to OMB Circular A-73 and EPA's General Counsel is currently preparing regulations and Claims Manual provisions consistent with the Federal Claims Collections Act. Our procedures for accounting for debts, billing and interest conform to current Department of Treasury and GAO guidance. The questions posed by the Subcommittee highlight the types of deficiencies cited in the GAO report; therefore, I have incorporated my more specific comments regarding these in the responses below.

Subcommittee question: At what point in the audit resolution process does EPA sustain a questioned cost as an audit disallowance and establish a claim? What conditions must be met?

EPA response: Audit exceptions are sustained as audit disallowances and established as accounts receivable at the time an authorized action official issues a final determination letter to the auditee. EPA's procedures require that final determinations be consistent with applicable regulations and policy, be reviewed and accepted by the Office of the Inspector General prior to issuance and be prepared within 120 days of the audit report date. Letters of determination must address each audit recommendation and element of cost questioned or set aside and advise the auditee of the amount due. In addition, the letter must specify the method of payment, interest penalties and the appeal procedures. Prior to the final determinations, costs questioned and set aside are monitored through the Agency's automated audit tracking system. Accounts receivable are monitored in an automated accounts receivable subsystem. Amounts disallowed are recorded in both systems and reconciled quarterly.

Subcommittee question: How does the Agency assure itself that the funds it receives in payment of audit disallowances are not Federal funds or do not reduce the intended benefits of EPA programs?

EPA response: Agency practices require that all debts be paid or repayment agreements be made prior to approval of new grant awards to a debtor. Where recoveries are to be made through offset, the Agency may deduct payment only from reimbursement for debtor claims of costs incurred. In this way, debtors cannot subsidize repayments through reduced effort under continuing awards. While there is no mechanism, except follow-up audits to ensure cash repayments are not made from non-EPA Federal funds, our grant conditions defining eligible costs prohibit such practice in the case of offsets. The Agency is taking steps to ensure that prohibitions on repaying disallowances with Federal funds are included in final determination letters.

Subcommittee question: Since 1979, the Federal Claims Collection Standards have required the charging of interest on all delinquent debts. Why has the EPA not been assessing interest on audit-related debts? When will this requirement be fully implemented?

EPA response: EPA's Financial Management Manual requires that interest charges be assessed against all delinquent debts, including audit-related debts unless compromised in accordance with the Federal Claims Collection Act. In October 1981, the interest policy was reemphasized and expanded to include requirements to accrue interest charges on all audit disallowances under appeal. Centralized monitoring of accounts receivable through the Agency's automated sub-ledger is ongoing and will ensure that this requirement will be fully implemented this year.

Subcommittee question: What is EPA's position on holding grantees responsible for subgrantee debts even when the grantee cannot collect from the subgrantee?

EPA response: The grant programs administered by EPA do not provide for subgrant agreements. However, it has always been the Agency's policy to hold grantees accountable for the performance and allowability of costs incurred under a grant regardless of whether these are the results of the grantee's efforts or those of its contractors or subcontractors. EPA's award and agreement are only with a grantee. Therefore, the Agency uniformly seeks to recover all disallowances directly from the grantee and does not consider or participate in any recovery action between a grantee and its contractors.

Your letter of February 24 also requested information on the current status of three audit disallowances. I feel the long delays in reaching determinations on two of these, Wayne County Health Department and Michigan Department of Health, are good illustrations of the low-priority given to audit resolution matters by previous managers at EPA. It should be noted, however, that receivables were properly and promptly booked for these disallowances at the time of determination, in accordance with the procedures described above. I understand that the third disallowance, Minnesota Pollution Control Agency, was the only instance of failure to identify and record a receivable identified by GAO in its 100% review of all audit disallowances in EPA's Regional Office between 1978 and 1980.

GAO's summary of the Wayne County Health Department disallowance does not reflect the substantial negotiations between the grantee and EPA regional officials that occurred between April 1980 and October 1981. Three offers and counter-offers were made and time was spent preparing a unique agreement which would ensure that the agreed upon deductions would be made only from drawdowns to cover expenses actually incurred by the grantee. In this way, EPA is assured that the grantee's level of performance under the current grant has not been reduced, but that their share of costs has increased. The grantee has signed the final agreement and the first $59,000 payment on the debt was made in November 1981. In this case, EPA waived the interest in order to collect the debt principal. The regulations implementing the Federal Claims Collection Act provide for compromise and settlement. The regulatory and EPA Claims Manual revisions mentioned above will ensure that all future settlements will be carefully reviewed and made only in accordance with the standards embodied in the joint regulations implementing the Claims Collection Act.

The appeal of the Michigan Department of Health disallowance, I understand, is still under review while additional documentation submitted by the grantee is considered. The Board of Assistance Appeals expects that the grantee and action official will be notified shortly with a decision regarding a major portion of the amount at issue. The debt was booked as an account receivable in the Region's manual record at the time of the 1980 determination and the receivable will be adjusted based on the decision of the appeals board. This appeal was filed prior to the Agency's implementation, last October, of a policy accruing interest on debts under appeal.

In the case of the Minnesota Pollution Control Agency, GAO has correctly identified a debt which was not recorded in the Agency's accounting system due to the poor coordination prevailing between program and finance officials at the time of the determination. Financial officials were not adequately involved in the discussions and agreements occurring between the grantee and program officials. Therefore, no action was taken to recover the debt from FY 1980 or 1981 grant reimbursement. Regional officials have now established the appropriate account receivable and will ensure that the debt is offset against reimbursements for costs incurred by the grantee under its current (FY 1982) award.

I am pleased to note that the Region audited by GAO, though initially slow to implement automated tracking of audit accounts receivable, has recently issued detailed procedures for audit resolution and follow-up which conform to OMB Circular A-73 and should correct the types of deficiences identified by GAO. This and the other actions we have taken, which I have described, illustrate the strong commitment of EPA's current managers to prompt identification and collection of debts arising from audits.

Sincerely yours,

Joseph A Cannon

Joseph A. Cannon
Acting Associate Administrator
for Policy and Resource Management

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

MAY 17 1982

OFFICE OF
[illegible] MANAGEMENT
RECEIVED
MAY 21 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman, Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On February 24, 1982, as Chairman of the House Committee on Government Operations, you released the General Accounting Office (GAO) report entitled "Federal Agencies Negligent In Collecting Debts Arising From Audits" (AFMD-82-32). As required under the provisions of section 236 of the Legislative Reorganization Act of 1970, we are submitting this statement advising the Committee on the actions the Environmental Protection Agency (EPA) has taken in response to the report's recommendations.

GAO Recommendation

That the head of each department or agency implement policies and procedures that will require a written determination of the allowability of all questioned costs within 6 months of audit report issuance.

EPA Response

At EPA, audit exceptions are sustained as audit disallowances and established as accounts receivable at the time an authorized action official issues a final determination letter to the auditee. Our procedures require that final determinations be consistent with applicable regulations and policies, be reviewed and accepted by the Office of the Inspector General prior to issuance, and be prepared within 120 days of the audit report date. Letters of determination must address each audit recommendation and element of cost questioned or set aside and advise the auditee of the amount due. In addition, the letter must specify the method of payment, interest penalties, and the appeal procedures.

GAO Recommendation

That the head of each department or agency implement policies and procedures that will ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

EPA Response

Accounts receivable are established in the Agency's official accounting system within one workday after receipt of a copy of the letter of determination sent to the auditee by the action official. Prior to the final determinations, costs questioned and set asides are monitored through the Agency's automated audit tracking system, which is supervised by the Office of the Inspector General. Accounts receivable are monitored in an automated accounts receivable subsystem, as part of EPA's financial management system. Quarterly reconciliation of the two systems assures that disallowed costs are accurately reflected in the accounts receivable records.

GAO Recommendation

That the head of each department or agency implement policies and procedures that will ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of fundings.

EPA Response

An aggressive collection program consistent with Federal Claims Collection Standards is underway at EPA. Specific procedures for followup of unpaid receivables at 30-day intervals after the initial billing date have been a standing requirement of our Financial Management offices for several years. Since introduction of the automated accounts receivable subsystem, the process has been simplified and provides Agency management with responsive data for evaluating the effectiveness of our debt collection efforts. Updated policies and procedures on administration of the Federal Claims Collection Standards at EPA are nearly completed and will give added impetus to the final resolution of disputed and appealed claims. In addition, coordination between financial management activities and the EPA Claims Office has proven an effective method of collecting debts.

GAO Recommendation

That the head of each department or agency implement policies and procedures that will hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees.

EPA Reponse

Our grant programs provide for agreements between only EPA and the grantee. It has always been the Agency's policy to hold grantees accountable for the performance and allowability of costs incurred under a grant, whether based on a grantee's or its contractor's performance. As a result, EPA seeks to recover all disallowances directly from the grantee.

GAO Recommendation

That the head of each department or agency implement policies and procedures that will ensure compliance with the Claims Collections Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

EPA Response

The termination of debts process is administered in strict compliance with the Federal Claims Collection Standards. The policies and procedures on EPA's administration of these standards and recent directives have been reemphasized and clarified the permissible procedures for compliance. In addition, recent improvements in the control of audit exceptions and accounts receivable procedures will provide top management with more effective controls in this sensitive area.

GAO Recommendation

That the head of each department or agency implement policies and procedures that will streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

EPA Response

The audit disallowance appeal process, administered under provisions of 40 CFR 30.1100, is by nature a time-consuming and complex task requiring extensive research and negotiation in many cases. Every effort is now being made to expedite final resolution of all open appeals. At EPA, improvement in the Audit Management System has contributed to the acceleration of resolving appeals, including revitalization of actions by the Audit Resolution Board to resolve internal differences on audit disallowances. Agency policy requires the accrual of interest charges on all audit disallowances under appeal.

GAO Recommendation

That the head of each department or agency implement policies and procedures that will require interest to be charged and collected on all debts, at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition.

EPA Response

EPA's Financial Management Manual requires that interest charges be assessed against all delinquent debts, including audit-related debts, unless compromised in accordance with the Federal Claims Collection Act. Audit-related debts begin 30 days after the debt is established. In October 1981, the interest policy was reemphasized and expanded to include requirements to accrue interest charges on all audit disallowances under appeal. Centralized monitoring of accounts receivable, through the automated accounts receivable subsystem, is ongoing and ensures that this recommendation will be fully implemented this year.

GAO Recommendation

That the head of each department or agency require grantee debtors to certify that their payment of audit-related debts has not reduced the level of performance of any Federal program. GAO further recommends that a followup system be established whereby grant management staff closely monitor performance of grantees to ensure that settlement of debts does not adversely affect grantee performance. This system should also include provision for audit followup, whereby routine verification is made part of the subsequent audit of grantees paying off audit-related debts.

EPA Response

EPA requires that a grantee's debts be paid or a repayment agreement be made prior to approval of new grant awards. When recoveries are made through offset, the Agency may deduct payment only from reimbursement for debtor claims of costs incurred. In this way, debtors cannot subsidize repayments through reduced effort under continuing awards. While there is no mechanism, except for followup audits, to ensure that cash repayments are not made from non-EPA Federal funds, our grant conditions prohibit such practice in the case of offsets. The Agency is taking action to ensure that prohibitions on repaying disallowances with Federal funds are included in final determination letters.

In conclusion, EPA has recognized the need for improving our debt collection program and, during the past year, has implemented a number of policies and procedures in response to deficiencies cited in this report. We will continue our efforts to improve the debt collection program in the belief that our work will result in a more comprehensive and effective program.

We appreciate the opportunity to present this statement in response to the GAO report's recommendations.

Sincerely yours,

Joseph A. Cannon

Joseph A. Cannon
Acting Associate Administrator
for Policy and Resource Management

APPENDIX 2.—CHAIRMAN BROOKS' LETTER TO DEPARTMENTS AND AGENCIES OF GOVERNMENT AND RESPONSES

JACK BROOKS, TEX., CHAIRMAN
DANTE B. FASCELL, FLA.
DON FUQUA, FLA.
ELLIOTT H. LEVITAS, GA.
DAVID W. EVANS, IND.
HENRY A. WAXMAN, CALIF.

FRANK HORTON, N.Y.
JOHN N. ERLENBORN, ILL.
M. CALDWELL BUTLER, VA.
WILLIAM F. CLINGER, JR., PA.

225-5147

NINETY-SEVENTH CONGRESS
Congress of the United States
House of Representatives
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-373
WASHINGTON, D.C. 20515

February 24, 1982

Honorable Thomas W. Pauken*
Director
ACTION
Washington, D.C. 20525

Dear Mr. Pauken:

Enclosed for your review and comment is the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits."

The GAO review was performed at my request as the result of a series of hearings that were held by the Subcommittee on the failure of Federal departments and agencies to follow up and resolve audit findings. Deficiencies in the collection of audit disallowances were brought up repeatedly during the Subcommittee hearings.

The Subcommittee would appreciate your comments regarding the reasons for any deficiencies found by the GAO in your procedures and practices, as well as the actions you are taking to comply with Federal collection regulations and OMB guidelines.

I hope that we can receive your comments by March 30, 1982. Your cooperation and immediate attention in reviewing and commenting on this report would be sincerely appreciated. I look forward to your response.

With best wishes, I am

Sincerely yours,

ORIGINAL SIGNED BY
Jack Brooks

JACK BROOKS
Chairman

Enclosure

*An identical letter was also sent to the heads of the following departments and agencies:

CIVIL AERONAUTICS BOARD
COMMERCE DEPARTMENT
CONSUMER PRODUCT SAFETY COMMISSION
DEFENSE DEPARTMENT
ENERGY DEPARTMENT
EQUAL EMPLOYMENT OPPORTUNITY COMMISSION
FEDERAL EMERGENCY MANAGEMENT AGENCY
GENERAL SERVICES ADMINISTRATION
INTERIOR DEPARTMENT
INTERNATIONAL COMMUNICATION AGENCY
JUSTICE DEPARTMENT
LEGAL SERVICES CORPORATION (No response)
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
NATIONAL ENDOWMENT FOR THE HUMANITIES
NATIONAL SCIENCE FOUNDATION
NUCLEAR REGULATORY COMMISSION
OFFICE OF PERSONNEL MANAGEMENT
SMALL BUSINESS ADMINISTRATION
SMITHSONIAN INSTITUTION
STATE DEPARTMENT
TENNESSEE VALLEY AUTHORITY (No response)
TREASURY DEPARTMENT
U.S. POSTAL SERVICE
VETERANS ADMINISTRATION

ACTION
WASHINGTON, D.C. 20525

OFFICE OF
THE DIRECTOR

April 20, 1982

Honorable Jack Brooks
Chairman
Legislation and National Security
  Subcommittee of the
Committee on Government Operations
U. S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter enclosing a copy of the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits."

As we noted in our letter of March 8, 1982, our Inspector General Division is reviewing ACTION's audit resolution system. This review includes an assessment of the agency's debt collection practices and procedures. We consider the institution of appropriate accounting and collections controls to be important steps to insure that audits are properly resolved.

Once the review is complete, we will take the necessary steps to insure that ACTION's audit resolution system includes effective procedures for collecting monies due to the Government. The General Accounting Office's report has been helpful in our review and its recommendations provide valuable guidance in strengthening this system.

Sincerely,

Thomas W. Pauken

Thomas W. Pauken
Director

PEACE CORPS • VISTA • UNIVERSITY YEAR FOR ACTION • NATIONAL CENTER FOR SERVICE LEARNING •
FOSTER GRANDPARENT PROGRAM • RETIRED SENIOR VOLUNTEER PROGRAM • SENIOR COMPANION PROGRAM

APR - 6 1982

CIVIL AERONAUTICS BOARD
WASHINGTON, D.C. 20428

IN REPLY REFER TO B-1-40

APR 1 1982

Honorable Jack Brooks
Chairman, Subcommittee on Legislation
  and National Security
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter of February 24 requesting the Civil Aeronautics Board's (CAB) comments on the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits."

My staff has assured me that we are in compliance with prescribed Treasury regulations. Our procedures are that, once a debt is established and it is unpaid after 30 days, interest begins accruing at the prescribed Treasury rate.

I want to thank you for the opportunity to participate and comment on the study. You have my assurance that the CAB will continue to monitor its receivables and apply all necessary collection procedures.

Sincerely,

Dan McKinnon

Dan McKinnon
Chairman

RECEIVED
APR 6 1982
Legislation and National
Security Subcommittee

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Administration
Washington, D C 20230

0 5 APR 1982

Honorable Jack Brooks
Chairman, Committee on Government
Operations
House of Representatives
Washington, D.C. 20515

RECEIVED
APR 5 1982
Legislation and National
Security Subcommittee

Dear Mr. Chairman:

This is in response to your request for comments on the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits."

Although the Department of Commerce was not one of the agencies audited, we have had to address many of the problems discussed in the report. We have made progress in the past year toward correcting these problems.

The Office of the Inspector General in the Department of Commerce established a system to monitor all audit findings and recommendations until they have been resolved. This has assisted the Inspector General in making outstanding progress towards closing audits which were not resolved after six months. A year ago the Department had 766 contract and grant audit reports and 234 management audit recommendations not resolved after six months. By the end of December, the backlog was reduced to 154 contract and grant reports and 7 management audit recommendations. It is probable that the backlog will be close to zero by the end of this month. This reduction was achieved despite the fact that thousands of new reports were processed during the year.

In addition, we have established a related system to track collection of disallowed costs. Next month we will issue a detailed report on the status of unresolved audits and collections which will reflect the progress which has been made over the past year.

Last week a Department audit resolution directive was issued outlining the policies and procedures to be used in the follow-up and resolution of audit recommendations and recording receivables resulting from audit resolution. The Department is developing debt collection policies which will address the problems of accounting and collection controls and poor management practices discussed in the report. These policies will be completed during the third quarter of the fiscal year.

Sincerely,

Arlene Triplett

Arlene Triplett
Assistant Secretary for
Administration

U.S. CONSUMER PRODUCT SAFETY COMMISSION
WASHINGTON, D.C. 20207

20 APR 1982

The Honorable Jack Brooks
Chairman
Legislation and National Security Subcommittee
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Chairman Steorts has asked that I reply to your letter of February 24, 1982, regarding the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits." I apologize for the delay in responding.

The Consumer Product Safety Commission does not have any grant programs. However, we average seven cost-reimbursement contracts each year. On completion of the work under those contracts, the billed costs are reviewed to determine the costs that are allowable under the contracts. In addition, questionable contracts and all contracts over $200,000 are audited. Disallowed costs under this process are off-set by monies routinely withheld under the contract terms pending final closing of the contract. As noted in Appendix II of the GAO report, this Commission had no disallowed costs outstanding as of June 30, 1981.

The nature of our contracts and programs is such that we do not ordinarily have outstanding debts and, therefore, do not need to take remedial actions to address the important, substantive issues raised by GAO in this report.

Sincerely,

Frederick A. Ruth

Frederick A. Ruth
Director of Congressional Relations

RECEIVED
APR 21 1982
Legislation and National
Security Subcommittee

THE SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

8 APR 1982

RECEIVED
APR 5 1982
Legislation and National
Security Subcommittee

RECEIVED
APR 2 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman, Committee on
Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of February 24, 1982, in which you requested comments on the General Accounting Office (GAO) audit report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits" (AFMD-82-32), January 22, 1982.

We have reviewed the audit report and concur with the recommendations made by GAO. We believe that the Department of Defense (DoD) does a creditable job in the overall management and liquidation of debts arising from audits.

As noted by GAO in the report, the procedures used by DoD in the pre-award process usually surface questioned costs. When the contract is negotiated, these questioned costs are resolved and disposed of in the negotiated total contract price. Subsequent disallowed costs are recorded as receivables and in most instances offset against contractor holdbacks before the contractor has been paid in full.

Should you or your staff require further information from DoD regarding the report, please let me know.

Thank you for permitting the Department of Defense to comment on the report.

Sincerely,

Frank C. Carlucci
Deputy Secretary of Defense

Department of Energy
Washington, D.C. 20585

RECEIVED
MAY 12 1982
Legislation and National
Security Subcommittee

MAY 3 1982

RECEIVED
MAY 11 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman, Committee on
Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

As required by Section 236 of the Legislative Reorganization Act of 1970, the Department of Energy (DOE) is providing the enclosed comments on General Accounting Office Report AFMD-82-32 entitled "Federal Agencies Negligent In Collecting Debts Arising From Audits."

DOE would be pleased to provide any additional information that is desired in this matter.

Sincerely,

William S. Heffelfinger
Assistant Secretary
Management and Administration

Enclosure

cc: Honorable Frank Horton
House of Representatives

DOE Comments on GAO Report "Federal Agencies Negligent In Collecting Debts Arising From Audits" AFMD-82-32

Following are the General Accounting Office (GAO) recommendations and the Department of Energy's (DOE) related comments.

GAO Recommendation

"... that the head of each department or agency implement policies and procedures that:

--Require a written determination of the allowability of all questioned costs within 6 months of audit report issuance."

DOE Comment

Under the Departmental order which established the DOE centralized audit followup system in December 1980, audit action officers are required to make a written determination on the actions to be taken on audit findings and recommendations within 6 months from the issuance of an audit report. This would include making a decision on the allowability of costs questioned by the audit.

Frequently, because of the complexities of the issues raised during the audit, it is then necessary to conduct negotiations with the contractor or grantee involved in order to arrive at the specific amount of money that is due the Government as a result of the audit findings. In DOE, the period of time required to complete negotiations is considered to be part of the final resolution process prescribed by the Office of Management and Budget (OMB) in Circular No. A-73 (revised) as occurring subsequent to the written determination.

GAO Recommendation

"... that the head of each department or agency implement policies and procedures that:

--Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness."

DOE Comment

DOE concurs with the GAO recommendation. It is the DOE policy to record all receivables on a timely basis; however, there are no specific guidelines regarding the recording of disallowed costs. The Controller is currently reviewing and rewriting the procedures for the establishment of accounts receivable for all disallowed costs after written determination of indebtedness. These procedures will also require the charging of interest consistent with the Treasury Fiscal Requirements Manual.

GAO Recommendation

"... that the head of each department or agency implement policies and procedures that:

--Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of funding."

DOE Comment

DOE concurs with the GAO recommendation. The Department has recently established a Cash Management Branch. A major function of this Branch is to monitor the collection action taken by field offices for DOE. DOE's financial offices currently age accounts receivable, assess interest in accordance with the Treasury Fiscal Requirements Manual, and mail past due notices on 30 day intervals. Other offset actions are also available when circumstances warrant and the need arises.

GAO Recommendation

"... that the head of each department or agency implement policies and procedures that:

--Hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees."

DOE Comment

Current DOE policies hold grantees responsible for their debts. This includes subgrantees, in accordance with applicable OMB and other governing regulations.

GAO Recommendation

"... that the head of each department or agency implement policies and procedures that:

--Ensure compliance with the Claims Collection Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less."

DOE Comment

DOE fully concurs in this recommendation. This recommendation is a reaffirmation of the Federal Claims Collection Act of 1966, Chapter II of Title 4, Code of Federal Regulations which are incorporated into DOE's accounting policy.

GAO Recommendation

"... that the head of each department or agency implement policies and procedures that:

> --Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal."

DOE Comment

The Department would be pleased to work with or assist OMB, other agencies and the legal community in reviewing the acquisition and assistance appeal process with a view toward streamlining the process. The Department would propose, and agree that as a part of this review, appropriate actions, including the starting date for charging of interest, should be considered. DOE will charge interest on receivables at the established Treasury Department rate once it is determined that a receivable does exist even though all formal appeal processes have not been exhausted. It is noted, however, that the appeals board or other appellate authority, or a Federal court if a dispute is taken there, will render the final determination regarding interest amount and the date from which it runs.

GAO Recommendation

"... that the head of each department or agency implement policies and procedures that:

> --Require interest to be charged and collected on all debts, at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition."

DOE Comment

DOE fully concurs with this recommendation. DOE currently assesses interest at the rate specified by the Treasury Fiscal Requirements Manual on all delinquent receivables.

GAO Recommendation

"... that heads of departments and agencies require grantee debtors to certify that their payment of audit-related debts has not reduced the level of performance of any Federal program. We further recommend that a followup system be established whereby grant management staff closely monitor performance of grantees to ensure that settlement of debts does not adversely affect grantee performance. This system should also include provision for audit followup, whereby routine verification is made part of the subsequent audit of grantees paying off audit-related debts."

DOE Comment

The Department does not feel it can adequately address this recommendation at this time. The full cost and impact of the proposed certification requirement, proposed monitoring of performance, and routine verification checks are not readily determinable. We believe further study of this issue would be necessary. For example, current OMB circulars applicable to federal assistance do not, in our view, necessarily contemplate or provide for close monitoring of performance to the degree implied by the GAO recommendations. Further, non-profit organizations follow the single-audit concept and may not, under current regulations, be scheduled for followup audits for several years beyond the collection or payment dates. This recommendation fully recognizes that indiscriminate collection tactics can work against the public interest. DOE considers that the impact upon a grantee's viability, and consequent ability to make restitution, as well as upon other Federal programs needs to be considered in selecting collection tools. DOE accordingly believes that the negotiation process in which an attempt is made to arrive at a mutual resolution of the amounts receivable should also give consideration to the selection of viable methods of repayment. Federal case law limits federal remedies against grantees where such remedies adversely affect the ultimate beneficiaries. Were the grantee asked to certify that payment of audit related debts does not reduce the level of benefits, the grantee simply could certify to the contrary, thus excusing itself from repayment. It is not the place of the grantee to so certify; it is the grantor agency's responsibility to determine the effects of its demand for repayment.

EQUAL EMPLOYMENT OPPORTUNITY COMMISSION
WASHINGTON, D.C. 20506

OFFICE OF THE CHAIR

MAR 2 9 1982

Honorable Jack Brooks
Chairman
Legislation and National Security Subcommittee
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Chairman Brooks:

This is in reply to your letter of February 24, 1982 requesting "Federal Agencies Negligent in Collecting Debts Arising from Audits." I fully support the recommendations for improving debt collection made by the Comptroller General.

Recently, my two top financial management positions, vacant for some months, were filled. A complete review of our debt collection procedures is being made and a revised directive will be issued this fiscal year. This will be in compliance with Federal Collection regulations and OMB guidelines.

It should be noted that accounts receivable are now established at such a time as final negotiations are conducted, although the final audit report is also utilized. Starting last month, steps were taken to ensure the accurate establishment of accounts receivable and collection procedures for amounts due.

Please contact me if I can be of further assistance.

Sincerely,

Cathie A. Shattuck
Acting Chairman

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AP : 4
Legis:
Security [illegible]

Federal Emergency Management Agency
Washington, D.C. 20472

MAY 14 1982

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MAY 19 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS
Legislation and National
Security Subcommittee

Honorable Jack Brooks
Chairman
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Reference is made to the General Accounting Office Report (GAO), AFMD-82-32 dated January 22, 1982.

We have reviewed the Report carefully. My enclosed response sets forth the pertinent sections of our Claims Collection Manual as they relate to the GAO's recommendations. The responses are keyed to the recommendations of the referenced report by page number.

Sincerely,

Charles M. Girard, Ph.D.
Associate Director
Resource Management and Administration

Enclosure

GAO REPORT, AFMD-82-32, January 22, 1982, ENTITLED:
"FEDERAL AGENCIES NEGLIGENT IN COLLECTING DEBTS ARISING FROM AUDITS"

Specific Comments by the Federal Emergency Management Agency (FEMA) to this Report are:

Page 17: RECOMMENDATIONS

"We recommend that the head of each department or agency implement policies and procedures that:

--Require a written determination of the allowability of all questioned costs within 6 months of audit report issuance.

--Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

--Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of fundings.

--Hold grantees fully responsible for the debts of their sub-grantees and apply the Claims Collection Standards in collecting these amounts from grantees."

RESPONSE

FEMA Instruction 1270.2 mandates the steps required to respond to all audit findings in final audit reports within a 60-day time limit, unless a written statement is furnished the Inspector General justifying an extension.

In addition, FEMA is in the process of adding to the FEMA Instruction 1270.2 the words, "However, all final audit reports require a written determination of the allowability of all questioned costs within six months of audit report issuance."

FEMA is in the process of developing a Claims Collection Procedures Handbook, which will include this requirement.

Our present claims collection procedures which have been in effect since April, 1981, include the production of a monthly report aging accounts receivable, and identifying those items when appropriate collection letters have or have not been written at 30, 60 and 90-day intervals.

We are at this time holding all grantees responsible for the debts of their subgrantees, and offsetting the payment of claims accordingly.

Page 25: RECOMMENDATIONS

"We therefore recommend that the head of each department and agency implement policies and procedures that:

--Ensure compliance with the Claims Collections Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

--Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

--Require interest to be charged and collected on all debts, at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition."

RESPONSE

Since its inception, FEMA has not compromised the settlement of any claim, except pursuant to the standards specified in the FEMA Claims Collection regulations.

At the present time, interest accrues on indebtedness of all amounts under appeal. The interest is only forgiven to the extent that it applies to a portion of principle forgiven on appeal.

Each Regional Claims Collection Officer is advised quarterly of the new Treasury interest rate applicable to the Bills for Collection issued in any given calendar quarter. The Bills for Collection specify that the rate of interest (indicated thereon) will begin to accrue 30 days from the date of the Bill for Collection.

Page 28: RECOMMENDATIONS:

"We recommend that heads of departments and agencies require grantee debtors to certify that their payment of audit-related debts has not reduced the level of performance of any Federal program. We further recommend that a followup system be established whereby grant management staff closely monitor performance of grantees to ensure that settlement of debts does not adversely affect grantee performance. This system should also include provision for audit followup, whereby routine verification is made part of the subsequent audit of grantees paying off audit-related debts."

RESPONSE

The appropriate program Directors within FEMA have been advised to secure these certifications from the grantees.

GSA General
Services
Administration
Washington, DC 20405

RECEIVED
JUL 16 1982
Legislation and National
Security Subcommittee

RECEIVED
JUL 16 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

JUL 13 1982

Honorable Jack Brooks
Chairman, Committee on Government Operations
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Thank you for the opportunity to comment on the General Accounting Office (GAO) report entitled "Federal Agencies Negligent in Collecting Debts Arising From Audits" (AFMD-82-32), dated January 22, 1982.

Since 1979 GSA has been tracking and resolving internal IG and GAO recommendations. Beginning in Fiscal Year 1982, GSA began tracking IG external (pre- and post-award contract audit) reports. The following paragraphs point out efforts being undertaken within GSA and by outside organizations to assess the effectiveness of this effort and determine the need to modify our external audit report resolution procedures.

In conjunction with the Office of Management and Budget's (OMB) Debt Collection Project, we are currently surveying all the programs in the Agency to ensure compliance with Federal collection regulations and guidelines. We are also looking at the debt collection practices and procedures in the various programs in which non-Federal receivables are a factor.

GSA has been asked to participate in another OMB task force established to assess the effectiveness of audit resolution in three Executive departments and agencies. To accomplish this, GSA management and the Inspector General are working together to determine how effectively GSA has resolved audit related problems. In addition, GSA's audit resolution program is currently being formally audited by GSA's Inspector General and another GAO audit group. These reviews, coupled with GAO's subject report, will provide GSA management with a sound basis on which we can further refine our audit resolution system.

The general comments listed above plus the enclosed specific comments to each of GAO's recommendations demonstrate that GSA is moving forward with the development of an effective audit resolution program.

Sincerely,

Ray Kline
Deputy Administrator

Enclosure

GSA Comments to the GAO Report Entitled "Federal Agencies Negligent in Collecting Debts Arising From Audits" (AFMD-82-32), Dated January 22, 1982

Recommendation. Require a written determination of the allowability of all questioned costs within 6 months of audit report issuance.

Comment. We concur. In compliance with Federal Procurement Regulation (FPR) 1-3.811 and .812, GSA has required that a memorandum of negotiation be forwarded to the auditor on pre-award contract audits and a memorandum be forwarded to the auditors detailing the facts regarding post-award defective data audits and/or contract actions taken.

In 1980, GSA implemented procedures which required all proposed actions concerning price-reduction and/or defective pricing audits to be included in GSA's contract clearance process. The Federal Supply Service expanded this procedure by developing formal pre-negotiation position papers which represented management's initial written determination. GSA management and the IG are currently reviewing this concept for potential adaptation agency-wide and with certain modifications and additions, which should be decided upon within 90 days, we believe this process will meet the full intent of this recommendation.

Recommendation: Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

Comments: We concur. We are currently developing procedures which will require a receivable to be established when a final written determination and the demand for payment are issued. This procedure, which previously had been informally implemented, will be issued as a formal GSA procedure within 90 days.

Recommendation. Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of funding.

Comments: GSA Order 1215.2C, entitled "Collection and Compromise of Claims" requires aggressive action for the collection and compromise of claims. Specifically, the order requires that three written demands at 30 calendar day intervals "be made upon a debtor for payment of a claim".

Contact has been made with Dun and Bradstreet Corporation to explore the course of action to be taken in affecting a contractor's credit rating when an overdue debt is owed GSA.

Presently, the names of contractors indebted to GSA are sent to the U.S. Army Finance and Accounting Center for inclusion in their list of Contractors Indebted to the United States (The Army Hold-Up List). This alerts other Agencies of GSA's claim against contractors so that another Agency may offset.

The current debts of a contractor are taken into consideration in the evaluation of the credit worthiness of prospective contractors. Unless a claim is in formal dispute and/or terms have not been reached on the settlement of the claim, the contractor will not be considered financially responsible unless the Office of Finance recognizes extenuating circumstances.

Recommendation: Hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees.

Comment: The grant program in GSA is not considered material when compared to the contracting effort. At present, there are only about two hundred grants in effect, and the dollar amount of the average grant is such that performing an audit is not cost effective.

Recommendation: Ensure compliance with the Claims Collection Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

Comment: 31 U.S.C. 951-953 precludes the termination of any debts over $20,000 and specifies the Claims Collection Standards that are to be met before settlement of debts of $20,000 or less. The GSA Order in this regard (ADM 1215.2C) refers to the compromise, suspension, or termination of collection action of claims in favor of the Government of $20,000 or less. This Order also states, however, that "these regulations do not preclude the utilization of any other administrative remedy available for the settlement or adjustment of claims in favor of the Government."

While 31 U.S.C. 951-953 and GSA Order ADM 1215.2C referenced above address the termination of debts over $20,000, we are also subject to the Contract Disputes Act of 1978 (41 U.S.C. 601 et seq.) which, in certain instances, does not preclude compromise of claims in excess of $20,000. We believe the above described procedures meet the intent of this recommendation.

Recommendation: Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

Comment: The procedures described in our comments to the first recommendation outline several of the steps we have taken, up to this point in time, to eliminate delays. In addition, the establishment of the tracking system within the Office of Audit Resolution will allow us to expedite resolution actions through closer oversight.

In GSA contracts, GSA Form 1424, Clause 55 entitled "Payment of Interest on Government Claims," the contractor is put on notice that an amount payable and due the Government under the contract shall bear interest commencing 30 days after receipt of written notice from the contracting officer demanding payment at the rate which has been established by the Secretary of the Treasury pursuant to Public Law 92-41, 85 Stat 97.

Also, the contracting officer's demand letter includes a reference that interest will be charged if payment is not made by the specified date.

Recommendation: Require interest to be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition.

Comment: 41 CFR § 5A-7.102-50 states that "unless paid within 30 days following the receipt by the contractor of a written notice from the contracting officer setting forth an amount which has become due and payable from the contractor to the Government under this contract, such amount shall bear interest commencing 30 days after the receipt of such demand at the rate which has been established by the Secretary of the Treasury pursuant to Public Law 92-41, 85 Stat 97. Also, as stated in our comments above, contractors are informed of the payment of the interest requirement within the terms of the contract under Clause 55 of GSA Form 1424.

At the present time, the propriety of adopting the Current Value of Funds Rate specified by the Treasury Fiscal Requirements Manual is being considered by GSA's Office of Acquisition Policy. Other agencies, including the Department of Labor, are also looking into the feasibility of adopting the TFRM quarterly rate.

Payment of interest using the Renegotiation Board rate in addition to the above is also provided for in the following contract provisions set forth in the Federal Procurement Regulations:

-- 41 CFR 1-7.203-15 Interest
-- 41 CFR 1-8.212-1, 1-8.701, 1-8.702, 1-8.703, 1-8.704, 1-8.706, 1-8.804-2, 1-8.806-4 Termination
-- 41 CFR 1-30.403 and 130.414-2 Advance Payments
-- 41 FPR Temporary Regulation 55 Disputes Clause

We believe that the above referenced regulations and procedures, when properly implemented, meet the intent of this recommendation.

Recommendation: Require grantees to certify that their payment of audit-related debts does not reduce the level of benefits of any Federal program and institute program and audit followup.

Comment: The grant program in GSA is not considered material when compared to the contracting effort. At present, there are only about two hundred grants in effect, and the dollar amount of the average grant is such that performing an audit is not cost effective.

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

MAR [illegible] 1982

Honorable Jack Brooks
Chairman, Legislation and National
Security Subcommittee
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

RECEIVED
MAR 26 1982
Legislation and National
Security Subcommittee

Dear Mr. Chairman:

Thank you for your letter of February 24, 1982, requesting our comments on the General Accounting Office (GAO) report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits."

The Department of the Interior was not one of the seven agencies audited by GAO. However, we recognize that improvements are needed in our collection practices for disallowed costs resulting from audit findings.

In December 1981, the Department initiated a trial system for tracking all audits through resolution and implementation, including debt collection. This system is being monitored jointly by the Assistant Secretary - Policy, Budget and Administration and the Office of the Inspector General (OIG). Currently, it is being revised to correct some of its original deficiencies.

When the system is fully operational, all but one of GAO's recommendations will have been implemented. The enclosure shows the current status of each recommendation. At this time, we do not plan to implement the recommendation concerning the appeal process. The Department has very few audit disallowances appealed and, at this time, there is no need to streamline the process. However, if in the future the appeal process appears to be abused, as GAO found it to be in some other agencies, we will certainly reconsider the GAO recommendation.

Within one year of the final system's formal establishment through publication in the Departmental Manual, the OIG will audit its implementation within selected bureaus and offices. The audit will cover timeliness of audit resolution as well as debt collection activities relating to audit recommended recoveries.

Again, thank you for permitting us to comment on this matter.

Sincerely yours,

J. Robinson West
Assistant Secretary - Policy,
Budget and Administration

Enclosure

Enclosure

DEPARTMENT OF THE INTERIOR

Status of GAO Recommendations

Recommendation	Status
Require written determination within six months of issuance	Implemented
Ensure establishment of accounts receivable	Implemented
Ensure aggressive collection action	Implemented
Hold grantees responsible for subgrantees and apply Claims Collection Standards	Partially Implemented
Ensure compliance with Claims Collection Standards	Implemented
Streamline appeal process and charge interest during appeals	Not required at this time
Require interest be charged	Implemented
Require grantees to certify that payment does not reduce level of benefits	To be Implemented

International Communication Agency
United States of America
Washington, D.C. 20547

Office of the Director
USICA

May 5, 1982

RECEIVED
MAY 10 1982
Legislation and National Security Subcommittee

Dear Congressman Brooks:

As promised in my March 22 letter to you, we have thoroughly reviewed the Comptroller General's report on collecting debts discovered in audits, "Federal Agencies Negligent in Collecting Debts Arising from Audits."

Over the last 12 months, this Agency has given close scrutiny to how it carries out its responsibilities both for collecting such debts and for resolving audit findings (covered in the GAO report last year on "Continued Failure of Departments and Agencies to take Effective Action on Audit Findings"). Our intention is to comply fully with the regulatory requirements since these responsibilities are ones we feel are critical areas of management concern. We have worked to devise the best possible system so this Agency can fulfill its obligation to reduce costs to the American taxpayer whenever possible.

The system which the Agency has developed to take effective action on audit findings and debt collection is outlined below.

1. Once financial audit findings are completed, the Agency sends a grantee (vendor) a written request for payment on non-negotiable debts or a request for further documentation within 30 days for costs that are questioned.

2. Once the Agency makes a final decision on the amount owed or once a decision favoring the Agency is made after appeal, collection action starts.

The Honorable
Jack Brooks
Chairman
Legislation and National Security Subcommittee
of the Committee on Goverment Operations
U.S. House of Representatives

3. Our Agency Manual of Operations is being revised to provide for aggressive Agency action in collecting money due and to incorporate the application of interest charges for late payments (as specified by the Treasury Fiscal Requirements Manual).

4. A system for recording billings and collections of "Accounts Receivable-Appropriation Refunds" has been developed and will be computerized. This system covers vendor refunds, salary overpayments, and outstanding travel advances with written demands to be sent at 30-day intervals for all disallowed costs. On travel advances, for example, employees are required to account for such funds within 30 days after the travel is completed, postponed, or cancelled. If an accounting is not received after two notices, payroll deductions will be made.

The full implementation of this system will be effective in avoiding the deficiencies noted in the GAO reports if followed consistently and promptly. I pledge my efforts and those of Agency management to this end.

Sincerely,

Charles Z. Wick

Charles Z. Wick
Director

U.S. Department of Justice

Washington, D.C. 20530

MAY [illegible] 1982

RECEIVED

MAY 10 1982

RECEIVED
HOUSE COMMITTEE ON
MAY 11 1982 GOVERNMENT OPERATIONS
Legislation and National
Security Subcommittee

Honorable Jack Brooks
Chairman
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The Department of Justice (Department) is responding to your request for comments on the Comptroller General's report of January 22, 1982, entitled "Federal Agencies Negligent in Collecting Debts Arising from Audits" (AFMD-82-32).

This is the third in a series of General Accounting Office (GAO) reports citing Federal agencies' ineffective policies for managing and collecting audit-related debts owed by contractors and grantees. As a result of GAO's earlier report of October 1978, the Department strengthened its entire audit resolution and debt collection process, which is also consistent with the Administration's financial management priorities on debt collection and internal controls.

The Office of Justice Assistance, Research and Statistics (OJARS) is the Department's largest grant-making entity. OJARS revised and updated its guideline on audits (OJARS G 7140.1D, August 13, 1980) to comply with GAO's recommendations. It sets forth the procedures to be followed in (a) the distribution of all grant and contract audit reports pertaining to its programs prepared by the Department's Audit Staff, and (b) the resolution of audit findings and collection of audit-related debts. This comprehensive process is in compliance with Office of Management and Budget (OMB) Circular No. A-73.

Currently, when performing audits of nonprofit entities that result in recommendations affecting other Federal agencies, the Department's Audit Staff distributes copies of the report to such agencies, indicating the condition(s) and the corrective action(s) that the auditee intends to pursue. In those instances where an audit is performed for the Audit Staff by another Federal agency relative to a contract proposal, a negotiation memorandum is issued to that audit agency advising them of the actions taken on the recommendations of their report. The Audit Staff believes that with the full implementation of the entity audit concept under OMB Circular A-102, Attachment P, including the establishment of procedures for the audit resolution process for Federal cognizant agencies, coordination in this area will vastly improve.

OJARS revised audit policy and requirements, as set forth in OJARS M 7100.1B, "Financial and Administrative Guide for Grants," dated October 20, 1980, requires that the State-level Criminal Justice Councils obtain copies of subgrantee audit reports performed pursuant to OMB Circular A-102, Attachment P. It is the responsibility of the States, through the Criminal Justice Councils, to review the audit reports and determine the allowability of all questioned costs, specifically stating the action taken on each recommendation. The Departmental Audit Staff performs selective assessment reviews of the effectiveness and timeliness of the States' debt resolution process.

OJARS has already taken actions which directly address the specific recommendations of GAO's report. The recommendations and the related actions that have been taken are summarized in the following paragraphs.

The report recommends that a written determination of the allowability of all questioned costs be made within six months of audit report issuance. Consistent with a similar recommendation in the GAO report entitled "More Effective Action is Needed on Auditor's Findings--Millions Can be Collected or Saved," OJARS established an Audit Review Committee in August 1980 to ensure the timely and aggressive resolution of audit findings. Since its establishment, the Committee has eliminated the backlog of audit reports unresolved for more than six months.

As a follow-through of the above recommendation, GAO recommends policies and procedures be implemented to ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness. Under the OJARS audit resolution tracking system, reports are tracked until all findings are resolved, including collection of amounts determined to be due. At such time as attempts by the program office to collect are unsuccessful and amounts due have been sustained as valid claims by the Office of General Counsel, the Office of the Comptroller begins the billing process and simultaneously establishes an accounts receivable and billing control. Procedures are being considered which would establish control of disallowed costs at an earlier stage in the resolution process. Consideration is being given to establishing this control as soon as monetary exceptions are sustained as disallowed costs by the program office. The program office would then provide the Comptroller with the amounts of all questioned costs to be controlled. As an adjunct to the above, the Department has a draft order in the clearance process placing special emphasis on the need for timely recording as receivables of all amounts included in audit reports and sustained by program managers.

In terms of collection, GAO recommends that aggressive collection action be taken in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of funding. OJARS Instruction 1010.1A requires written demands for payment at 30-day intervals, and provides for referral to GAO or the Department if the claim is not collected and waiver is not appropriate in accordance with 4 CFR Part 104. GAO or the Department may waive, litigate for collection, or use the set-off method. Also, as a matter of internal policy, OJARS is refusing to process new awards to discretionary grantees with outstanding costs and to process administrative actions for formula grantees with unsatisfied Bills of Collection.

GAO also recommends that grantees be held fully responsible for the debts of their subgrantees and the Claims Collection Standards be applied in collecting these amounts from grantees. OJARS Manual 7100.1B, Financial and Administrative Guide for Grants, provides that "All grantees receiving direct awards from the grantor agency are responsible for the management and fiscal control of all funds. Responsibilities include the accounting of receipts and expenditures, the maintaining of adequate financial records and the refunding of expenditures disallowed by Federal or State audits" (underscore added). The Audit Review Committee, which has authority to compromise audit claims or suspend collection action, does not exercise that authority on the basis of a subgrantee's failure to reimburse the grantee.

The report further recommends that agencies ensure compliance with the Claims Collection Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less. Under OJARS Instruction 1010.1A, the head of OJARS or his designee may exercise compromise, suspension or termination of collection action not over $20,000. An action which does not exceed $2,500 is delegated to the Comptroller. In the case of audit findings, this authority is vested in the Audit Review Committee by OJARS Instruction 7140.3.

To expedite the collection process, GAO recommends the audit disallowance appeal process be streamlined to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal. In this regard, OJARS procedures do not provide for grantee appeals of program office determinations on audit findings.

As an incentive for debtors to pay Government debts, GAO recommends that interest be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition. OJARS Instruction 1010.1A meets this requirement by providing that "charges for late payments will be at the current Department of the Treasury rate . . . for each 30-day period or portion thereof that the payment is delayed."

GAO's final recommendation suggests that agencies (a) require grantees to certify that their payment of audit-related debts not reduce the level of benefits of any Federal program, and (b) institute program and audit follow up to verify the level of performance. This practice is not followed explicitly by OJARS. Most OJARS grantees are on Letter of Credit, and settlement of disallowed costs is usually accomplished through reduction in the award amount and Letter of Credit authorization. Performance level is an integral part of grant awards and is verified through regular grant management and audit follow up.

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We believe the vigorous action taken by the Department during the past four years in establishing procedures for the resolution and collection of amounts arising from audit-related findings clearly indicates our intent to comply with GAO's recommendations. Our efforts in this area are an important factor in maintaining the Department's credibility in the enforcement of grant conditions and Federal regulations, and in increasing program managers' ability to keep projects in line with approved plans and program goals.

We appreciate the opportunity to comment on the report. Should you desire any additional information, please feel free to contact me.

Sincerely,

Wm. D. Van Stavoren, Acting

for

Kevin D. Rooney
Assistant Attorney General
for Administration

NASA
National Aeronautics and
Space Administration

Washington, D.C.
20546

Reply to Attn of C:MAM:sah

Honorable Jack Brooks
Chairman
Subcommittee on Legislation and
National Security
Committee on Government Operations
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This letter is in response to your letter of February 24, 1982, in which you request that NASA comment on the General Accounting Office report entitled "Federal Agencies Negligent in Collecting Debts Arising from Audits", the reasons for any deficiencies found by the GAO in our procedures and practices, as well as actions taken by NASA to comply with Federal collection regulations and OMB guidelines.

For this report, NASA was not included in the seven agencies actually audited by GAO, however, we did participate in completing the questionnaire sent to all departments and agencies as reflected in Appendix II and III of the report. The report does not specifically mention NASA as having deficiencies in our procedures and practices regarding audit resolution.

There have been very few cases of disallowed or suspended costs in NASA. The majority of our contract auditing is performed by the Defense Contract Audit Agency (DCAA). Disallowed or suspended costs found are offset by them on the vouchers submitted to NASA for payment. If this is not possible, bills are rendered for amounts due and accounts receivable are established in our accounting systems.

NASA has fully implemented the provisions of the debt collection program; aggressive follow-up action is taken on amounts due. Interest is charged debtors for past due bills, and our accounts receivable from public sources is extremely small.

If we can be of any further assistance, please do not hesitate to call on us.

Sincerely,

/for
John F. Murphy
Assistant Administrator
for Legislative Affairs

NATIONAL ENDOWMENT FOR THE HUMANITIES

WASHINGTON, D.C. 20506

March 25, 1982

RECEIVED
MAR 30 1982
Legislation and National
Security Subcommittee

The Honorable Jack Brooks
Chairman, Legislation and National
Security Subcommittee
Committee on Government Operations
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This is in response to your letter of February 24, 1982 concerning the General Accounting Office (GAO) report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits." You ask for our comments on any deficiencies found by GAO in our procedures and practices, as well as on the actions we are taking to comply with Federal collection regulations and OMB guidelines.

The Endowment does have an adequate system for the accounting and collection of audit-related debts. When an audit finding is sustained, a letter requesting a refund is sent to the grantee by the Director of Administration. The Accounting Office establishes accounting control over the claim. Debtors are reminded 30 days after initial notification and again at 60 days. After 90 days, any outstanding debts are referred to the General Counsel for legal action. The Endowment has an excellent record of debt collection with no outstanding audit-related debts at this time.

Concerning the finding of slowness in determining the amount of debt discussed on page 7 of the GAO report, this agency has experienced difficulty in complying with the requirement to make written determinations on all audit findings within 6 months after issuance of audit reports. This was due primarily to a critical shortage in audit staff throughout most of fiscal year 1981, coupled with the inability to fill vacant positions due to the government-wide hiring freeze. The problem was somewhat alleviated toward the end of the fiscal year by assigning one additional auditor position to the Audit Office. The Endowment is currently recruiting for another staff auditor and will make a concerted effort to be in compliance with PL 96-304 by the end of this fiscal year.

With respect to the findings reported on pages 42 and 43 of the GAO report, outstanding debts in the past were minor in amount. We therefore considered our demand letters to be sufficient. You can be assured, however, that any future audit-related debt collection letters will instruct the debtor that payment must be from non-Federal funds and a certification to this effect will be required from the grantee at the time of payment of the debt.

The Endowment is in compliance with all of the recommendations contained on page iii of the GAO report, with one exception as noted above.

Sincerely,

William J. Bennett
Chairman

NATIONAL SCIENCE FOUNDATION
WASHINGTON, D.C. 20550

OFFICE OF THE
ASSISTANT DIRECTOR
FOR ADMINISTRATION

March 29, 1982

The Honorable Jack Brooks
Chairman, Legislation and National
Security Subcommittee
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Mr. Brooks:

This is in response to your request for comments from the National Science Foundation regarding reasons for any deficiencies (found by GAO in Foundation procedures and practices) in the collection of audit disallowances and actions taken to comply with Federal collection regulations.

Concerning the issue of followup and resolution of audit findings, a Foundation directive (copy enclosed) was issued and implemented on November 17, 1978. This directive (NSF Circular No. 145, Followup on Audit Reports) sets forth the Foundation's policies and procedures relative to audit findings and recommendations and assigns responsibility for actions required for timely disposition including quarterly status reports.

The Foundation has accounting control of audit disallowances. This control is accomplished by General and Subsidiary Ledger Accounts for outstanding advance payments to grantees. These are receivable accounts which are increased by cash advances and decreased by grantee costs. When grantee costs are disallowed, the decrease to the account is reversed; this reversal reestablishes the amount in the balance of the Advance (Receivable) Account.

Also enclosed is a copy of the NSF Claims Collection Manual. The policies and procedures prescribed in this Manual are based on collection activities prescribed in the Code of Federal Regulations (31 U.S.C. 951-953), the Claims Collection Act of 1966 (80 Stat. 309), and Title 4 of the GAO Policy and Procedures Manual. These procedures were issued and implemented in July of 1981.

If we can be of further assistance, please do not hesitate to contact us.

Sincerely yours,

TUbois

Thomas Ubois
Assistant Director
for Administration

Enclosures

(Subcommittee note: NSF Claims Collection Manual referred to has been retained in files.)

NATIONAL SCIENCE FOUNDATION
Office of the Director
Washington, D.C. 20550

NSF CIRCULAR NO. 145

ADMINISTRATION AND MANAGEMENT

November 17, 1978

Subject: **Followup on Audit Reports**

1. **Purpose.** This Circular sets forth Foundation requirements concerning followup on audit reports. It is to be noted that this Circular does not supplant Circular No. 90 which deals with the Foundation's relationship with the General Accounting Office.

2. **Cancellation.** None.

3. **Background.** The Foundation activities and those of its grantees and contractors are subject to audits by the Foundation's Office of Audit and Oversight (OAO), by audit agencies cognizant of Foundation grantees and contractors, and by the General Accounting Office. Audit reports identify costs which may be disallowed, system deficiencies, and areas for improvement in Foundation operations including specific recommendations for action by Foundation management.

4. **Authority.** Office of Management and Budget Circular A-73 (revised) dated March 15, 1978, requires each agency to establish policies for followup on audit recommendations. In addition, under the Budget and Accounting Procedures Act of 1950, the Comptroller General is required to prescribe principles, procedures, rules, and regulations for carrying out audit responsibilities, giving due regard to generally accepted principles of auditing, including consideration of the effectiveness of internal audit and control, and related administrative practices of the respective agencies.

5. **Policy.** The Foundation policy is to assure compliance with all Government regulations and policies and procedures applicable to its operations including appropriate followup on audit report recommendations.

6. **Procedures.**

a. *Distribution of Audit Reports.* Audit reports on Foundation, grantee, and contractor activities are issued by (a) the Office of Audit and Oversight, (b) Federal audit agencies performing audits of NSF grantees and contractors, and (c) the General Accounting Office. The distribution of all audit reports is made by the Office of Audit Oversight.

b. *Action on NSF Audit Report Recommendations.*

(1) Within Foundation. Each Foundation directorate will designate a representative who will be the focal point for coordinating action that is taken on recommendations in each audit report affecting that directorate's activities. The status of the resolution of each recommendation in an audit report will be furnished to the Director, OAO, within 60 days after distribution of the audit report. The status of recommendations which were unresolved at the time of the previous report will be reported quarterly to the Director, OAO, until each such recommendation is resolved.

(2) *Foundation Grantees and Contractors.* Under delegation from the Assistant Director for Administration, the Director, Division of Grants and Contracts (DGC), will be responsible for effecting the resolution of all report recommendations concerning Foundation grantees and contractors. In the resolution of audit report recommendations involving grantee and contractor institutions, the Director, DGC, will coordinate action as appropriate with the cognizant program directorate and with the audit resolution and/or negotiation activities of other agencies to assure that agreements reached are considered on a government-wide basis. Where feasible, agreements will be made with cognizant agencies to resolve recommendations directed to grantee and contractor administrative systems. The Assistant Director, AD/A, will furnish the Director, OAO, a quarterly report on the status of audit recommendations concerning grantees and contractors.

c. *Disagreements with Audit Report Recommendations.* When a directorate disagrees with an NSF audit report recommendation, the cognizant Assistant Director and the Director, OAO, will attempt to resolve the differences. Remaining disagreements will be presented jointly by the cognizant Assistant Director and the Director, OAO, to the Deputy Director, NSF, for resolution.

d. The Office of Audit and Oversight will monitor followup action on plans for changes in procedures in

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Please include this Circular in NSF Manual No. 16, "Handbook for Program Officers"

response to audit recommendations and evaluate the effectiveness of the actions taken and the effectiveness of the followup system.

e. The Director, OAO, will report quarterly to the Director on the status of audit findings and recommendations and the results of actions taken. Specific problems will be reported to the Director, NSF, by the Director, OAO, as necessary.

7. **Responsibilities.**

a. The Deputy Director, NSF, is responsible for resolving disagreements on audit recommendations which are presented to him by the Director, OAO, and the Assistant Director whose directorate is involved.

b. Assistant Directors are responsible for:

(1) Notifying the Director, OAO, of the name of the person who will be the directorate focal point for coordinating action on audit recommendations to the directorate;

(2) Ensuring that action is taken on audit recommendations relating to the directorate;

(3) Resolving disagreements on audit recommendations jointly with the Director, OAO, or presenting remaining disagreements to the Deputy Director, NSF; and

(4) Informing the Director, OAO, periodically of the status of resolution of audit recommendations relating to the directorate.

c. The Assistant Director for Administration is responsible for:

(1) Effecting the resolution of all audit report recommendations concerning Foundation grantees and contractors, coordinating with the cognizant program directorate as appropriate;

(2) Negotiating agreements with cognizant agencies for the resolution of audit recommendations concerning grantee and contractor administrative systems where feasible. Such agreements will be submitted to the NSF Director for final approval;

(3) Reporting quarterly to the Director, OAO, on the status of audit recommendations concerning grantees and contractors.

d. The Director, OAO, is responsible for:

(1) Distributing audit reports;

(2) Assigning responsibility for audit recommendations not assigned to AD/A in para. 7.c.(1) above;

(3) Maintaining a file on the status of all audit reports and recommendations and actions taken in response to such recommendations;

(4) Monitoring the timeliness and effectiveness of actions taken or promised in response to audit recommendations;

(5) Periodically evaluating the effectiveness of the audit resolution system;

(6) Resolving disagreements on NSF audit recommendations jointly with the appropriate assistant Director of presenting remaining disagreements to the Deputy Director, NSF (See b.3.);

(7) Reporting quarterly or more frequently, if necessary, to the Director, NSF, on the status of audit recommendations and their resolution.

Richard C. Atkinson

Richard C. Atkinson
Director

Distribution E

UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D.C. 20555

OFFICE OF THE
CHAIRMAN

RECEIVED
APR 29 1982
Legislation and National
Security Subcommittee

April 26, 1982

RECEIVED
APR 29 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

The Honorable Jack Brooks, Chairman
Committee on Government Operations
United States House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

In accordance with the statutory obligation to respond to recommendations by the General Accounting Office (GAO) within 60 days of publication, we hereby submit our responses to the recommendations made by the GAO in their report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits," (AFMD-82-32).

The Commission supports the eight recommendations made by the GAO. Specific comments on the Nuclear Regulatory Commission's compliance with the recommendations are presented in the Enclosure.

Sincerely,

Nunzio J. Palladino
Chairman

Enclosure:
Responses to GAO Recommendations

cc: Rep. Frank Horton

NRC Response to Recommendations to the Final GAO Report Entitled "Federal Agencies Negligent In Collecting Debts Arising From Audits"

Chapter 2

Recommendation 1

Require a written determination of the allowability of all questioned costs within six months of audit report issuance.

Recommendation 2

Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

NRC Response: The NRC has implemented procedures for follow-up of audit recommendations. These procedures are consistent with OMB Circular A-73. The six-month and 30-day time constraints cited in recommendations 1 and 2 will be added to these procedures by June 30, 1982.

Recommendation 3

Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of fundings.

NRC Response: The NRC has codified its debt collection procedures. These procedures have been implemented and they comply with Federal Claims Collection Standards.

Recommendation 4

Hold grantees fully responsible for the debts of their sub-grantees and apply the Claims Collection Standards in collecting these amounts from grantees.

NRC Response: To date, grantees under NRC's small grant program ($1,655,000 in FY 81) have not had sub-grantees. Should an NRC grantee have sub-grantees, NRC will hold the grantee fully responsible for the debts of its sub-grantees through the financial assistance agreement. The Federal Claims Collection Standards are applied in collecting any amounts due from grantees.

Chapter 3

Recommendation 5

Ensure compliance with the Claims Collections Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

NRC Response: The NRC's debt collection procedures concerning compromise and termination of debts are consistent with the Federal Claims Collection Standards. Debts in excess of $20,000 are referred for litigation to the General Accounting Office or the Department of Justice.

Recommendation 6

Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

NRC Response: The NRC's audit disallowance appeal process assures that unnecessary delays are eliminated. A late payment charge is imposed on each debt under appeal if such debt has been initially asserted by the NRC on or after March 24, 1982.

Recommendation 7

Require interest to be charged and collected on all debts at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition.

NRC Response: If a debt is not paid in full on or before the payment due date, the NRC assesses a late payment charge based upon the prevailing rate prescribed by the Treasury Fiscal Requirements Manual. The payment due date is normally 30 days from the date in the initial written demand (to date there have been no circumstances that warrant extending the payment due date beyond 30 days).

Chapter 4

Recommendation 8

Require grantee debtors to certify that their payment of audit-related debts has not reduced the level of performance of any Federal program. We further recommend that a followup system be established whereby grant management staff closely monitor performance of grantees to ensure that settlement of debts does not adversely affect grantee performance. This system should also include provision for audit followup, whereby routine verification is made part of the subsequent audit of grantees paying off audit-related debts.

NRC Response: The NRC grant program started in fiscal year 1980 and, to date, no NRC grantee has had an audit-related debt to the NRC. All grant agreements executed after June 30, 1982, will require grantee debtors to certify that their payment of audit-related debts does not reduce the level of performance of any Federal program. NRC grant management procedures will assure that settlement of debts does not adversely affect grantee performance.

United States
Office of
Personnel Management
Washington, D.C. 20415

In Reply Refer To
Your Reference

APR 7 1982

Honorable Jack Brooks
Chairman, Committee on
Government Operations
U.S. House of Representatives
Washington, D.C. 20515

RECEIVED
APR 12 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

RECEIVED
APR 13 1982
Legislation and National
Security Subcommittee

Dear Mr. Chairman:

This is our response to your letter of February 24, 1982, which asked for our comments on recommendations contained in GAO's January 22, 1982 report, AFMD-82-32, Federal Agencies Negligent in Collecting Debts Arising from Audits.

The Office of Personnel Management recognizes the benefits of prompt and proper resolution of audit findings and collection of disallowed costs. We have continuously strived to ensure prompt resolution of audit findings. For example, on July 1, 1981, OPM had over $12 million dollars in unresolved audit findings -- largely applicable to audits of insurance contracts under the Federal Employees Health Benefits and Federal Employees Group Life Insurance programs. During that period an additional $8.1 million was questioned. On December 31, there were no unresolved audit findings which were over six months old, with the exception of a minor amount which was subsequently resolved within the next 30 days.

The thrust of GAO's report concerned the adequacy of Federal agencies' accounting and debt collection controls. In that regard, the majority of OPM's audit disallowances arise in the Federal employee benefits programs. When these costs are disallowed the government does not immediately retrieve funds from insurance carriers. Therefore, OPM does not establish a receivable. Instead, the carriers are required to increase the special reserve funds which they maintain by an amount equal to the costs disallowed. These funds represent the surplus or deficit of premiums received versus claims paid. The fund balances are monitored by OPM and are considered when determining premiums for future insurance contracts. An extensive tracking system maintained by OPM assures that amounts disallowed are properly adjusted. When a contract is terminated the insurance carrier becomes liable for settling its special reserve in which case a debt may arise to the government. OPM collects any balance due the government after two years when all insurance claims are presumed settled.

Within OPM, audit related debts still arise in the now defunct Intergovernmental Personnel Act grant program. Previously, disallowed costs in the grant program were recovered through offset against future awards. However, in a recent review of the phase-out of the grant program, OPM's Inspector General made recommendations to ensure that our fiscal offices promptly bill grantees for any unexpended balances or disallowed costs. In collecting these debts as well as other amounts owed the government, OPM's fiscal offices follow administrative procedures which comply with "The Federal Claims Collection Standards". We are currently reviewing our administrative guidelines and we intend to outline procedures which specifically detail the settlement of audit related debt.

In closing, I support your concern for prompt and proper resolution of audit findings and collection of disallowed costs. We will continue to place a high priority on these activities within OPM.

Sincerely,

Donald J. Devine
Director

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

RECEIVED
APR 21 1982

RECEIVED
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS
APR 26 1982

Legislation and National
Security Subcommittee

APR 15 1982

Honorable Jack Brooks
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

My Office, in conjunction with the Small Business Administration's Offices of the Inspector General, Controller, and Procurement, have reviewed the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits." We concur in the GAO list of recommendations pertaining to the implementation of Agency policies and procedures. In the event that indebtedness should arise either in our contractual or our public assistance agreement activities, the following procedure will be enforced.

1. Contractors and Grantees will be notified in writing upon determination that questioned costs reflected in our audit reports have been determined to be disallowed. This correspondence will include the nature of the disallowed cost, the specific amount disallowed, and a due date for reimbursement to the Agency, usually 30 days. The notification letter will further state that an account receivable is being established simultaneously and will remain on the Agency's books until such time as reimbursement is received.

2. By copy of the letter to the Contractor or Grantee, the Controller will be informed by the contracting officer that an account receivable is to be established pertinent to the specific entity involved.

3. Upon receipt of payment from the contractor or grantee, it will be processed according to established procedures within the Agency and the account receivable will be cancelled.

4. In the event that payment is not received within 30 days of original notice, a second notice will immediately be issued with a further 30-day grace period.

5. In the event that payment is not received in response to the second notice, a third notice will be issued to the contractor or grantee alerting him to the fact that if payment in full is not received within an additional 30 days the matter will be referred to the Office of General Counsel for appropriate action.

6. In the event that payment is not received in response to the third notice within 30 days, the Office of General Counsel will be requested to initiate action to recover in the claim.

The caveats included in the recommendations and discussions in the GAO report are well taken. Particularly in the case of grantees, program officers have been cautioned to be alert for any deficiencies in performance which may relate to offsets that have been enforced due to nonremittance of funds owed the Agency.

The spirit of your Committee studies as well as the recommendations emanating from the General Accounting Office, is refreshing and if implemented will lead to a more businesslike and efficient conduct of Government business.

Sincerely,

James Sanders

James C. Sanders
Administrator

RECEIVED
MAR 24 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

SMITHSONIAN INSTITUTION
Washington, D.C. 20560
U.S.A.

23 March 1982

RECEIVED
MAR 24 1982
Legislation and National
Security Subcommittee

Honorable Jack Brooks
Chairman, Committee on
Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for sending me a copy of the January 22, 1982 General Accounting Office report titled, "Federal Agencies Negligent in Collecting Debts Arising From Audits."

At the Smithsonian, we have followed the guidance in OMB Circular A-73, and have established what we believe is an effective system for follow-up on audit findings. GAO commented on the effectiveness of our system in their October 25, 1978 report, titled "More Effective Action is Needed on Auditors' Findings - Millions can be Collected or Saved."

Due to the small size of our operation and the nature of the procurements we award, the Smithsonian does not have many auditable contracts and grants. However, when audit findings indicate that grantees or contractors have spent Federal or Smithsonian Trust funds for unauthorized purposes, the misspent funds are properly and promptly recovered.

I commend you and your subcommittee for your efforts in improving the Government's audit process.

Sincerely yours,

S. Dillon Ripley
Secretary

DEPARTMENT OF STATE
Washington, D.C. 20520

RECEIVED
MAR 26 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

MARCH 25 1982

Dear Chairman Brooks:

Thank you for providing the Department of State with a copy of the General Accounting Office report concerning resolution of audit findings. We are pleased to note that GAO reported no deficiencies pertaining to the Department of State in the collection of audit disallowances.

The Department has taken positive steps to resolve audited cost disallowances. In fact, of the $733,000 identified in the report as audit disallowances, over 90% of these costs have been resolved through appropriate action by our Inspector General staff and audited bureaus. We are diligently working to resolve all of the questioned costs.

Our Inspector General is working closely with Department Debt Collection officials; both are complying with OMB Circular A-73 and OMB Bulletin 81-17 requirements.

The Department is committed to helping the Administration achieve one of its high priority goals -- effective Debt Collection policies and procedures.

Sincerely,

Powell A. Moore
Powell A. Moore
Assistant Secretary for
Congressional Relations

The Honorable
Jack Brooks, Chairman,
Committee on Government Operations,
House of Representatives.

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MAR 26 1982
Legislation and National
Security Subcommittee

RECEIVED
APR 12 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

April 6, 1982

Dear Mr. Chairman:

In response to your letter of February 24 and in accordance with Section 236 of the Legislative Reorganization Act of 1970, we are providing comments on GAO Report AFMD-82-32, dated January 22, 1982, entitled "Federal Agencies Negligent in Collecting Debts Arising From Audits."

GAO's report shows that debts arising from audits within Treasury have not been significant. Specifically, there were no disallowed costs during fiscal years 1978-1980 as a result of grant audits because Treasury is not a grant-making agency. Costs disallowed as a result of post-award audits of contracts amounted to $155,000 in the three-year period. These debts involved two of Treasury's 12 bureaus, the Federal Law Enforcement Training Center and the U.S. Secret Service. The report indicates that the entire debt of $155,000 was collected by the Treasury Department.

Although debts arising from audits are not a significant problem for the Treasury Department, we plan to conform departmental directives on audit resolution and follow-up with the accounting and collection controls required by OMB Circular A-50. Currently, OMB is revising A-50 to strengthen the audit resolution and follow-up requirements in Circular A-73. Treasury's understanding is that OMB, in revising A-50, will consider and incorporate many of the recommendations in the subject GAO report.

We appreciate the opportunity to furnish our comments and assure you that debt collection is a high priority within the Treasury Department.

Sincerely,

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APR 12 1982
Legislation and National
Security Subcommittee

W. Dennis Thomas
Assistant Secretary
(Legislative Affairs)

The Honorable
Jack Brooks
Chairman, Subcommittee on
  Legislation and National Security
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

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MAR 25 1982
Legislation and National
Security Subcommittee

THE POSTMASTER GENERAL
Washington, DC 20260

March 23, 1982

RECEIVED
MAR 23 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Dear Mr. Chairman:

This refers to your February 24, 1982 letter regarding the General Accounting Office report entitled, "Federal Agencies Negligent in Collecting Debts Arising From Audits.

The Postal Service was not one of the seven agencies GAO audited in detail, and although we did respond to GAO's questionnaire on audit disallowances, it did not really fit our situation.

The Postal Service does not engage in any grant programs and, with few exceptions, conducts its purchasing/acquisition functions through advertised, competitively bid, firm fixed price contracts. As a result, very few contract receivables are ever encountered. Disallowances from firm fixed price contracts merely reduce the amount owed and are customarily adjusted before final payment is made at the conclusion of the settlement process. In those infrequent cases when there is a receivable from a contract—and in the case of postage deficiencies and payment balances from international mail—we do establish and control receivables.

The great majority of Postal Service debt collection efforts involve employee indebtedness—currently employed, retired or terminated employees. The Postal Service has an accounts receivable system that provides for automatic billings, voluntary and involuntary set-offs and reporting to the Office of Personnel Management of debts due on retiring and/or terminated employees.

In short, we believe our receivable and debt collection procedures and practices are sound and effective. Nevertheless, we have begun a review to determine whether there are any areas where improvements might be made, in the light of GAO's recommendations.

Sincerely,

William F. Bolger

Honorable Jack Brooks, Chairman
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Office of the
Administrator
of Veterans Affairs

Washington, D.C. 20420

**Veterans
Administration**

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APR 1 1982
Legislation and National
Security Subcommittee

MARCH 31 1982

RECEIVED
APR 1 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

Honorable Jack Brooks
Chairman, Committee on Government
  Operations
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This responds to your letter of February 24, 1982, requesting comments on the General Accounting Office (GAO) report entitled, "Federal Agencies Negligent in Collecting Debts Arising from Audits." You asked me to comment on the reasons for deficiencies GAO found in Veterans Administration (VA) procedures and practices, and on the actions the VA is taking to comply with Federal collection regulations and Office of Management and Budget (OMB) guidelines.

Our September 30, 1981, response to the GAO questionnaire on debts for disallowed costs (reflected in report Appendices II and III) indicated that information was not available for most items. Although this may appear to reflect deficiencies in our procedures, this is not the case. The VA does not maintain a recordkeeping system which separately identifies accounts receivable associated with audit-related debts. Therefore, we were unable to provide the statistical information GAO requested.

VA policy requires prompt recording of receivables, aggressive collection actions, and compliance with the Claims Collection Standards on termination of debts. We implemented procedures to comply with Public Law 96-526, enacted in July 1980 (HUD-Independent Agencies Appropriation Act, 1981), and Public Law 96-304, enacted in December 1980 (Supplemental Appropriations and Recission Act, 1980). These procedures require written determinations, on audits which question costs, within 6 months of audit report issuance. The Office of Inspector General closely monitors these audits to assure Agency compliance. This effort has been quite effective as evidenced by the fact that we resolved all of our old audits by September 30, 1981, as mandated by the Senate Committee on Appropriations Report accompanying Public Law 96-304. We also anticipate having no unresolved audits over 6 months old for the reporting period ending March 31, 1982.

A revised VA policy has been developed, based on OMB's proposed revision of Circular A-50 on audit resolution and followup, and on guidance received from the Presidential Council on Integrity and Efficiency. This policy was concurred in by all departments and staff offices. It includes the requirement for a written determination within 6 months, and after the determination, prompt recording of a receivable. The other requirements stated in the GAO recommendations will be incorporated in our policy, including the stipulation that receivables will be recorded within 30 days after the written determination.

The recommendation which requires interest to be charged on debts is scheduled for implementation in November 1982. One recommendation addresses streamlining the audit disallowance appeal process. There are inherent and unavoidable time-consuming steps in the appeal process which have been deliberately established in order to guarantee that each party is afforded due process. The Board of Contract Appeals takes whatever action is necessary to avoid undue delay in the processing of appeals to the extent possible under the Contract Disputes Act of 1978 and the Board's rules of procedure. The Board will continue to exercise control over the appeals process to ensure the elimination of unnecessary delay.

I will be providing comments on the GAO report recommendations to other Members of the Congress, as required by the Legislative Reorganization Act of 1970, and will send you a copy of those comments.

Sincerely,

Bob Nimmo

ROBERT P. NIMMO
Administrator

Office of the
Administrator
of Veterans Affairs

Washington, D.C. 20420

**Veterans
Administration**

RECEIVED
MAY 14 1982
HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS

MAY 12 1982

Honorable Jack Brooks
Chairman, Committee on Government
  Operations
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Section 236 of the Legislative Reorganization Act of 1970 requires me to submit a written statement on the Comptroller General's January 22, 1982, report, "Federal Agencies Negligent in Collecting Debts Arising from Audits," AFMD-82-32. This report indicates the General Accounting Office (GAO) found deficiencies in Veterans Administration (VA) procedures and practices for collecting debts arising from audits. Our September 30, 1981, response to the GAO questionnaire on debts for disallowed costs (reflected in report Appendices II and III) indicated this information was not available for most items. Although this may appear to reflect deficiencies in our procedures, this is not the case. The VA does not maintain a recordkeeping system which separately identifies accounts receivable associated with audit-related debts. Therefore, we were unable to provide the statistical information GAO requested.

During their review, GAO found that Federal procedures for collecting debts resulting from audit findings need significant improvement and made several recommendations to improve department and agency efficiency in collecting audit-related debts. The enclosure contains my comments on the recommendations.

Sincerely,

Bob

ROBERT P. NIMMO
Administrator

Enclosure

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MAY 17 1982
Legislation and National
Security Subcommittee

ENCLOSURE

VETERANS ADMINISTRATION'S COMMENTS ON THE COMPTROLLER GENERAL'S JANUARY 22, 1982, REPORT, "FEDERAL AGENCIES NEGLIGENT IN COLLECTING DEBTS ARISING FROM AUDITS," AFMD-82-32

In order to improve Federal procedures for collecting audit-related debts, GAO recommends that the head of each department and agency implement policies and procedures that:

—Require a written determination of the allowability of all questioned costs within 6 months of audit report issuance.

VA implemented procedures to comply with Public Law 96-526 (HUD-Independent Agencies Appropriation Act, 1981), enacted in July 1980, and Public Law 96-304 (Supplemental Appropriations and Recission Act, 1980), enacted in December 1980. On audits which question costs, the procedures require written determinations within 6 months of report issuance. The Office of Inspector General closely monitors these audits to assure Agency compliance.

This effort has been quite effective as evidenced by the fact that all of our old audits were resolved by September 30, 1981, as mandated by the Senate Committee on Appropriations Report accompanying Public Law 96-304. Also, there were only two unresolved audits over 6 months old on March 31, 1982.

—Ensure establishment of accounts receivable for all disallowed costs within 30 days of the written determination of indebtedness.

—Ensure aggressive collection action in accordance with the Claims Collection Standards, which include written demands for payment at 30-day intervals, affecting the debtor's credit rating, offsetting the debt against amounts due from other Federal programs, and suspension or termination of fundings.

--Ensure compliance with the Claims Collections Standards to preclude the termination of any debts over $20,000 and ensure that all Claims Collection Standards concerning compromise and termination are met before settling debts of $20,000 or less.

A revised VA policy has been developed, based on a proposed revision of Office of Management and Budget Circular A-50 which covers audit resolution and followup, and on guidance received from the President's Council on Integrity and Efficiency. This policy was concurred in by all VA departments and staff offices and includes the requirement for a written determination within 6 months. The stipulation that receivables be recorded within 30 days after the written determination is made will be incorporated in the revised policy before it is issued.

Current VA policy requires prompt recording of receivables, aggressive collection actions, and compliance with the Claims Collection Standards on termination of debts.

—Hold grantees fully responsible for the debts of their subgrantees and apply the Claims Collection Standards in collecting these amounts from grantees.

All future correspondence will be addressed to the grantees who will be responsible for the actions of subgrantees.

The VA accounting systems are designed to classify receivables in two broad categories, Federal and non-Federal. For that reason, it is difficult to look at the accounts for an appropriation or fund and determine the amount of contract-related receivables. However, grant programs in the VA have unique appropriation symbols so the amount of outstanding grantee receivables can be identified. As of February 28, 1982, the VA grantee program had two open receivables totaling $290.

--Streamline the audit disallowance appeal process to ensure that unnecessary delays are eliminated and that interest is charged on all amounts under appeal.

--Require interest to be charged and collected on all debts, at the rate specified by the Treasury Fiscal Requirements Manual, beginning no later than 30 days from establishment of the debt and continuing until collection or final disposition.

I concur, but there are inherent and unavoidable time-consuming steps in the appeal process which have been deliberately established to guarantee that each party is afforded due process. The Board of Contract Appeals takes whatever action is necessary to avoid undue delay in the processing of appeals to the extent possible under the Contract Disputes Act of 1978 and the Board's rules of procedure. The Board will continue to exercise control over the appeals process to ensure elimination of unnecessary delay.

VA policy for an aggressive collection effort, appeals procedures, and termination of debts is contained in VA Manual MP-4, Part I, Chapter 5. Charging of interest on debts owed the VA is scheduled for implementation in November 1982.

GAO recommended that heads of departments and agencies require grantee debtors to certify that their payment of audit-related debts has not reduced the level of performance of any Federal program. They further recommended that a followup system be established whereby grant management staff closely monitor performance of grantees to ensure that settlement of debts does not adversely affect grantee performance. This system should also include provision for audit followup, whereby routine verification is made part of the subsequent audit of grantees who are paying off audit-related debts.

I concur and this recommendation will be implemented.

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